Supreme Court, U.S.
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No. OFFICE OF THE CLERK

IN THE

Supreme Court of the United States

PEOPLE OF THE STATE OF NEW YORK and THE PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK,

Petitioners,

-v-

FEDERAL ENERGY REGULATORY COMMISSION,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

PETITION FOR A WRIT OF CERTIORARI
Volume I

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QUESTIONS PRESENTED

1. Whether, given that Congress in 1935 stated that federal regulation extends "only to those matters which are not subject to regulation by the states" (Federal Power Act (FPA) § 201(a)), and the transmission of energy from generators to retail customers in the same state was then "subject to regulation by the states" (as it has been since 1935), may the Federal Energy Regulatory Commission (FERC) preempt state jurisdiction over such intrastate retail transmissions of electric energy?

2. Whether, given that FPA § 201(b) expressly denies FERC jurisdiction over local distribution facilities, may FERC preempt state jurisdiction over local distribution facilities when they are used for wholesale sales?

3. Whether FERC can assert jurisdiction over costs utilities incur to provide retail services when those costs become unrecoverable as a result of competition?

4. Should the Court, in resolving questions 1-3, defer to FERC's reading of its own jurisdictional limitations?

PARTIES

Petitioners are the Public Service Commissions of Florida, New York and Wyoming, the Public Utilities Commissions of Idaho and North Carolina, the New Jersey Board of Public Utilities, the Vermont Board of Public Utilities, the Virginia State Corporation Commission, the Washington Utilities and Transportation Commission, and the National Association of Regulatory Utility Commissioners. Pursuant to Rule 29.6 of this Court's Rules, none of the Petitioners/Intervenors State Utility Commissions, which are governmental agencies, needs to file a corporate disclosure statement.

The National Association of Regulatory Utility Commissioners (NARUC) is a quasi-governmental non-profit corporation organized under the laws of the District of Columbia. The NARUC has no corporate parents or affiliates that have issued shares or debt securities to the public. Within its membership are the governmental bodies of the fifty States engaged in the economic and safety regulation of carriers and utilities. The remaining parties to the underlying proceeding are listed in Petitioners' Appendix, "Pet. App." R.

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PETITION FOR A WRIT OF CERTIORARI

Petitioners/Intervenors State Public Service Commissions, which regulate retail electric rates and service for some 63 million people, and the National Association of Regulatory Utility Commissioners (State Commissions et al.), petition for a writ of certiorari to review a judgment of the United States Court of Appeals for the D.C. Circuit that allowed the Federal Energy Regulatory Commission (FERC) to (1) preempt state regulation of the transmission of electricity from generators to retail customers in the same state, (2) preempt state regulation of local systems used to deliver electricity when the electricity is resold, and (3) set transmission rates that recover a utility's generation costs "stranded" due to municipalization or retail competition.[1]

OPINIONS BELOW

The Opinion of the District of Columbia Circuit, Pet. App. C, is at _ F.3d _, 2000 U.S. App. Lexis 15362. The Court's order on rehearing (Pet. App.A) is not officially reported. FERC Order 888 is reported at FERC Stats. & Regs. ¶ 31,036, 61 Fed. Reg. 21,540. FERC's rehearing decisions (Orders 888-A and 888-B) are reported respectively at FERC Stats. & Regs. ¶ 31,048 and 81 FERC ¶ 61,248 (1997). Pertinent portions of the FERC orders are supplied in Pet. App. D, E, and F.

JURISDICTION

The judgment of the Court of Appeals was entered June 30, 2000. The order denying rehearing was issued August 22, 2000. The Petition for Certiorari is timely because it was filed within 90 days from the date of denial of the Petition for Rehearing en banc. Supreme Court Rule 13(3). The Petition for Rehearing en banc was filed within 45 days of the D.C. Circuit's judgment, as required by D.C. Circuit Rule 35. This Court has jurisdiction under 28 U.S.C. § 1254(1).

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[1] "Municipalization," "retail transmission," "wholesale sales" and other relevant terms are defined in the Glossary of Terms contained in the Appendices, Pet. App. Q.

STATUTORY PROVISIONS INVOLVED

The relevant statutory provisions are provided in Pet. App. G.

STATEMENT OF THE CASE

A. Enactment Of The Federal Power Act

Electric service involves the generation of electricity and either (i) its transmission and local distribution to the ultimate consumer (a retail sale) or (ii) its transmission to a reseller (a wholesale sale) who transmits and distributes the power to an end user (a retail sale). State commissions have traditionally regulated all aspects of bundled retail transactions, including service issues and the intrastate sale and distribution of electricity.

Traditionally, FERC has regulated wholesale power sales and interstate transmission of electricity, which represent a small percentage of the total revenues from use of electric systems. See H. Rep., Hearings Before The Subcommittee on Communications and Power of the Committee on Interstate and Foreign Commerce, 90th Cong., 1st Sess. (1967), 1967 Hearings, Testimony of FPC Chairman Lee C. White at 124. Pet App. H-14. In particular, when Congress enacted the 1935 Federal Power Act (FPA), the states were regulating the rates that utilities charged to deliver electricity from a generator to a retail consumer in the same state. H. Rep., Hearings Before the Subcommittee on Interstate and Foreign Commerce, 74th Cong., 1st Sess. (1935) "1935 Hearings," Testimony of FPC Commissioner Clyde L. Seavey, at 420. Pet. App. I-4.

Congress passed the FPA not to override state regulation -- indeed it insisted state regulation was not to be affected -- but to fill a jurisdictional gap created by a Supreme Court decision that states could not set rates for wholesale energy sold across state lines. Public Utilities Comm'n of Rhode Island v. Attleboro Steam and Electric Co., 273 U.S. 83, 89 (1927). Congress filled this "Attleboro Gap" by empowering the Federal Power Commission (FPC) to regulate wholesale electricity rates because, in the absence of federal regulation, there would be no regulation of interstate sales. Hence, § 201(a) provides that federal regulation is "however, to extend only to those matters which are not subject to regulation by the States" (emphasis added).

In closing the "Attleboro Gap," Congress preserved the states' jurisdiction over the intrastate retail transmission of electricity. In fact, the FPA expressly safeguarded state regulation of all retail sales and local distribution systems. FPA § 201(b). While Congress empowered the FPC to regulate wholesale sales of electricity in interstate commerce, it expressly provided that the FPC, now Federal Energy Regulatory Commission (FERC), was not to regulate (a) any aspect of the delivery of electricity from a generator to a retail consumer in the same state,[2] or (b) the use of local distribution facilities.[3] This Court has emphasized that the specific language of FPA section 201(b) expressed Congress' intent to draw a "bright line" easily ascertainable between state and federal jurisdiction:

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[2] FPA § 201(a), (b)(1), (c) [16 U.S.C. § 824(a), (b) and (c)]; § 212(h) [16 U.S.C. § 824k(h)].

[3] FPA § 201(b)(1) [16 U.S.C. § 824(b)(1)].

> What Congress did was to adopt the test developed in the Attleboro line which denied state power to regulate a sale 'at wholesale to local distributing companies' and allowed state regulation of a sale 'at local retail rates to ultimate consumers.' [citation omitted].

Federal Power Commission v. Southern California Edison Co., 376 U.S. 205, 214 (1964).

The FPA's legislative history is consistent with its express language preserving state jurisdiction. In 1935, most electric facilities were intrastate facilities. 1935 Hearings, at 420. Pet. App. I-12. House Rep. No. 1318, 74th Cong., 1st Sess. (1935) at 7. Pet. App. P-22. Thus, states' rights advocates in Congress added the "intrastate" clause to the FPA "so that [the Act] specifically will not apply to intrastate business." New York Times, June 8, 1935, "Utility Foes Map Floor Fight;" see 1935 Hearings, Testimony of John E. Benton, General Solicitor, NARUC, at 760, 763 et seq; see also Senate Rep. No. 621, 74th Cong., 1st Sess. (1935) at 18. Pet. App. J-1; K-5 and P-4.

FERC's predecessor, the Federal Power Commission (FPC), repeatedly conceded that the purposes of the FPA were limited to filling the "Attleboro gap" and protecting state jurisdiction. Dozier DeVane, Solicitor of the FPC, stated to the House Committee on Interstate and Foreign Commerce that:

> ... [S]ection 201 is intended to give the Federal Power Commission jurisdiction over the wholesale rates only. (1935 Hearings at 497) ... [T]he plan of this bill with reference to the regulation of rates [is that] it seeks to leave in the state commissions the power to regulate retail rates but through some federal agency assist the state commissions making

> available to them the proper data for the determination of those rates.

1935 Hearings, at 520. Pet. App. L-14. Further, the FPC acknowledged to Congress in 1947 that its jurisdiction did not include "the regulation of rates and service outside of [the Attleboro Gap]." A Bill to Amend Section 201 of the Federal Power Act, Hearings Before Subcommittee on Interstate and Foreign Commerce, 80th Cong., 1st Sess., (hereinafter "1947 Hearings"), at 506. Pet. App. M-1. The FPC stated "The bill provides that the [FPC] may regulate the rates that no State commission can regulate. The bill simply fills this gap and that is all." 1935 Hearings at 549. Pet. App. L-34.

B. FERC's Decision Under Review

Notwithstanding the FPA's clear reservation of state authority over retail and intrastate matters, in 1998 FERC preempted state regulation of both the delivery of electricity from a generator to a retail consumer in the same state and the use of local distribution facilities to deliver electricity that is resold. FERC envisioned the introduction of competition, not only in its jurisdictional market (wholesale sales) but also in the state jurisdictional retail market and concluded that competition allowed it to expand its jurisdiction in three areas.

First, FERC asserted jurisdiction over retail transactions when states unbundled retail rates into charges for delivery and electricity.[4] Specifically, FERC reasoned that if states specifically identified a transmission rate, FERC could preempt state jurisdiction over the rates end-users paid for the transmission of energy to retail customers. Order 888,

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[4] "Unbundling" permits competition for energy sales to retail customers by breaking ("unbundling") a monopoly rate for delivery of energy and energy into two rates; one for energy and the other for delivery.

1991-1996 FERC Regulations and Preambles (hereinafter Stats. & Regs.) ¶ 31,036 at 31,980. Pet. App. D-121-D-124.

Second, FERC decided that if a seller of unbundled wholesale energy made use of a local distribution system, FERC -- not the states -- would set the rates that the seller would pay for the use of those local distribution facilities. Pet. App. F-7-F-8. Depending on the level of FERC's rates, this dual regulation of local distribution facilities could invite competitors' suppliers to structure "sham" wholesale sales in order to avoid state jurisdiction. See FPA § 212(h) [directing FERC not to issue orders that induce sham wholesale sales].

Third, FERC preempted the states' rate treatment of power plant costs incurred by utilities to serve retail customers, that may be "stranded" (unrecoverable by utilities) due to competition. While this is another area regulated by the states since well before 1935, FERC asserted that it has authority over the rate treatment of such "retail stranded costs," arising from a customer's choice of a new electric supplier, because of its claimed authority over unbundled retail transmission. Recognizing, however, that states had authority over retail stranded costs, FERC declined to exercise its purported authority unless the state regulatory authority lacked power under state law to address retail stranded costs. In those circumstances, FERC stated it would include in transmission rates power plant costs incurred by utilities under state regulation to serve retail customers. FERC further asserted jurisdiction over utility generation costs that were stranded by retail customers becoming wholesale customers, for instance, through the formation of municipal electric utilities or the expansion of existing ones.[5] FERC stated that it would be the

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[5] An entity that had previously been served by an investor-owned electric utility could decide to municipalize, form its own municipal electric utility, become a wholesale customer, purchase bulk power from the wholesale

primary decision-maker on the recovery of those costs. Pet. App. D-64-D-65, D-80-D-84, E-24-E-25, E-71-E-74.

C. The D.C. Circuit's Decision

On June 30, 2000, the D.C. Circuit[6] upheld all aspects of FERC's preemption. Rather than examine whether Congress had intended to allow such preemption, as required by the Supreme Court (e.g., Fidelity Federal Savings and Loan Ass'n v. De la Cuesta, 458 U.S. 141, 162 (1982)), the Panel deferred to FERC's interpretation of the FPA's jurisdictional limitations. Opn. at 30-31. Pet. App. C-33 to C-34.

In upholding FERC's preemption of state regulation of retail transmission, the Court below read Federal Power Comm'n v. Florida Power & Light Co. (FP&L), 404 U.S. 453 (1972) and Jersey Central Power & Light Co. v. Federal Power Comm'n, 319 U.S. 61, 73 (1943), Opn. at 28-30, Pet. App. C-30-C-31, as holding that FERC had jurisdiction over all unbundled transmission of electric energy on interconnected grids, even transmissions from a generator in the center of a state to a retail customer next door to the generator's plant. Opn. at 28-31. Pet. App. C-30-C-34. Reasoning in the alternative, the D.C. Circuit noted that it felt FERC's interpretation of the FPA's jurisdictional limitations was entitled to deference. Opn. at 31, Pet. App. C-33-C-34.

FPA Section 201(b)(1) denies FERC authority over "facilities used in local distribution," "except as specifically provided in this

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market, and resell power to its inhabitants. In that case, utility costs previously incurred to serve the area (such as installed generating capacity) could be stranded.

[6] The relevant portions of the D.C. Circuit's decision on transmission and distribution jurisdiction were written by Judge Sentelle. Stranded cost issues were addressed by Judge Tatel. Slip Opinion "Opn." 4. Pet. App. C.

subchapter and subchapter III" [16 U.S.C. § 824(b)(1)]. Opn. at 31-32, Pet. App. C-34 to C-35. Working from an assumption that § 201(a)'s grant of power to FERC over wholesale sales overrides § 201(b)(1)'s directive that FERC not regulate local distribution facilities (Opn. at 34, Pet. App. C-37), the D.C. Circuit upheld FERC's preemption of state regulation of local distribution facilities.

The D.C. Circuit also (1) decided FERC could "backstop" state decisions on the rate treatment of power plant costs stranded as a result of retail competition and (2) held that FERC could be the "primary forum" for recovery of costs stranded as a result of the loss of retail customers to wholesale competition. Opn. at 73-76, 80-85, Pet. App. C-80 to C-84, C-87 to C-93.

REASONS FOR GRANTING THE WRIT

The D.C. Circuit's decision conflicts with numerous decisions of this Court. It also raises extremely important questions, which go to the heart of a 65-year-old federal/state dual regulatory scheme. One such question is whether a statute designed to preserve state authority and to limit federal regulation to matters that could not be regulated by the states can be used to preempt state jurisdiction over services traditionally regulated by the states.

The Supreme Court consistently has articulated a stringent legal standard for determining whether federal law allows preemption of state law. Where federal agency action preempts activities traditionally regulated by the states, the Court "'start[s] with the assumption that the historic police powers of the States were not to be superseded ... unless that was the clear and manifest purpose of Congress.'" Hillsborough County, Florida v. Automated Medical Labs., Inc., 471 U.S. 707, 715 (1985) (quoting Jones v. Rath Packing Co., 430 U.S. 519, 525 (1977)); Arkansas Elec. Coop. Corp. v. Arkansas Pub. Serv. Comm'n, 461 U.S. 375, 383 (1983). The Hillsborough standard is on point, but even if it did not apply, this case would raise the question whether the teaching of Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837 (1984), calling for deference to agency readings of statutes they enforce, should extend to an agency's construction of a statute that expressly limits its authority. The Court below held that FERC should receive deference in construing provisions of the Federal Power Act that circumscribe its powers. Opn. at 30-31, Pet. App. C-33-C-34.

The FPA was enacted to fill the "Attleboro gap" and leave untouched state authority over intrastate retail services. FERC has relied upon expanded interconnection by utilities to override Congress' limitation and claim jurisdiction over utility deliveries of energy from generators to consumers in the same state. In so doing, FERC has misapplied this Court's decisions in Federal Power Comm'n v. Florida Power & Light Co., and Jersey Central, which upheld federal jurisdiction over limited aspects of utility operations, not over intrastate retail transactions on utility systems.

The D.C. Circuit's decision also ignored the decisions of this Court that the Federal Power Act simply filled the "Attleboro gap" and otherwise preserved state power over the regulation of utilities. FPC v. Southern California Edison Co., 376 U.S. 205 (1964); Arkansas Elec. Coop. Corp. v. Arkansas Pub. Serv. Comm'n, 461 U.S. 375, 394 (1983).

Another important question is whether the FERC can undermine state authority to ensure reliable and reasonably priced electricity by overriding the FPA's prohibition of federal regulation of local distribution facilities when electric providers structure electric sales as sales for resale. The D.C. Circuit's decision ignores the FPA's preservation of state authority over local distribution systems and its prohibition of sham wholesale sales that would defeat state jurisdiction.

Finally, the D.C. Circuit's decision raises a question as to whether FERC may cross the "bright line" created by this Court's decision in FPC v. Southern California Edison and assert jurisdiction over generation costs incurred to provide retail service.

ARGUMENT

POINT I

THE DECISION ALLOWING FERC TO PREEMPT THE STATES' REGULATION OF THE TRANSMISSION OF ELECTRICITY FROM A GENERATOR TO A RETAIL CUSTOMER IN THE SAME STATE CONFLICTS WITH THIS COURT'S TEACHING IN HILLSBOROUGH, IMPERMISSIBLY DEFERS TO FERC'S READING OF THE STATUTE LIMITING THAT AGENCY'S JURISDICTION AND CONFLICTS WITH CONGRESS' RESERVATION OF STATE JURISDICTION OVER INTRASTATE TRANSMISSIONS OF ELECTRICITY

1. As discussed above, this Court has held that where the field that a federal agency seeks to preempt was traditionally occupied by the states "we start with the assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress." Hillsborough County, Florida v. Automated Medical Labs., 471 U.S. at 715 (1985), quoting Jones v. Rath Packing, 430 U.S. at 525; see Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230 (1947) (citations omitted).[7] It is uncontested that (1) the states were regulating the transmission of electricity from generators to retail customers in the same state when Congress enacted the Federal Power Act (1935 Hearings, FPC Solicitor Devane, at 556, Pet. App. L); and (2) there is no evidence of a clear and manifest intent by Congress to authorize preemption of state regulation. FERC Order 888 at 31,780 (Pet. App. D-42).

Although the states stressed in brief and argument that FERC had not satisfied the Hillsborough standard, the Court below made no mention of Hillsborough, relying instead on a misreading of Chevron U.S.A. Inc. v. Natural Resources Defense Council, 467 U.S. 837 (1984), and a misapplication of Oklahoma Natural Gas Co. v. FERC, 28 F.3d 1281, 1283-1284 (D.C. Cir. 1994) to afford seemingly limitless deference to FERC's interpretation of the Federal Power Act's jurisdictional limitations.[8] The D.C. Circuit's decision conflicts with Hillsborough as well as numerous decisions of this Court.

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[7] This assumption provides assurance that "the federal-state balance," United States v. Bass, 404 U.S. 336, 349 (1971), will not be disturbed unintentionally by Congress or unnecessarily by the courts.

[8] Even if the Hillsborough standard of review does not apply, the D.C. Circuit's decision to grant deference to FERC's reading of a federal statute presents a critical issue of state/federal authority, not only because it was made in an area of traditional state authority, but because it was made concerning a statute expressly confining the agency's authority. Throughout its decision, the Court below predicated its decision on deference to FERC's construction of provisions of the Federal Power Act that are designed to cabin that agency's own jurisdiction and reserve jurisdiction to another regulator, i.e., the state public utility commissions (see, e.g., Opn. at 30-31, Pet. App.C-33-C-34) ["it is the law of this circuit that the deferential standard of Chevron U.S.A., Inc. v. Natural Resources Defense Council ... applies to an agency's interpretation of its own statutory jurisdiction" (citation omitted)].

2. The D.C. Circuit's substitution of deference under Oklahoma Natural Gas Co. v. FERC, 28 F.2d 1281 (D.C. Cir. 1994), for the Hillsborough standard and its willingness to render nugatory, by FERC's own admission, FPA § 201(c), present the following, exceptionally important question: may courts uphold federal preemption of long-standing state regulation based not on what Congress intended when it enacted the federal agency's enabling statute, but on what they surmise, in this case incorrectly, to be a federal/state balance that best advances the public interest?

It is vitally important that the Court review this case to answer this question in the negative, and affirm that traditional state police power regulation cannot be shunted aside based on federal agency rules rather than explicit congressional direction. This case uniquely presents the question of deference in the context of a federal agency rule that has usurped more than eight decades of state regulation of electric service.

3. The D.C. Circuit upheld FERC's position that (a) Congress granted FERC jurisdiction of interstate transmissions of electricity; and (b) this Court's decision in Florida Power & Light, plus increased interconnection between utilities in different states, render interstate all transmissions of electricity. It is the second premise -- regarding Florida Power & Light and increased interconnection -- that is fraught with error.

4. The D.C. Circuit's reliance on Federal Power Comm'n v. Florida Power & Light Co., 404 U.S. 453 (1972), as supporting FERC jurisdiction over all transmissions of electricity on interconnected grids is terribly misplaced. In that case, which did not involve federal preemption of state regulation, the Supreme Court held that the Federal Power Commission had authority to examine the books of a Florida utility because one or more electrons from Florida Power & Light's facilities flowed out of state. 404 U.S. at 454, 461. The Court's conclusion that some electrons on the utility's system flowed in interstate commerce did not, however, suggest, even remotely, that every electron on Florida Power's system was in interstate commerce. Yet, based perhaps on FERC's assurance that Florida Power was dispositive (FERC Brief at 67-69), the Court below read Florida Power's holding that FP&L transmitted some electrons in interstate commerce as a holding that all electrons carried by all interconnected utilities are in interstate commerce. Opn. at 29-30 (Pet. App. C-32 to C-33). The D.C. Circuit's inductive expansion of Florida Power equates to an argument that because humans have white blood cells and John Smith is a human, all of John Smith's blood cells are white. It is fallacious. Just as the existence of white blood cells in human beings does not render red blood cells non-existent, the fact that some electrons cross state lines does not render transmissions from generators to customers in the same state interstate (See FPA § 201(c) [which states that only transmissions from generators to customers in different states are interstate]).

5. FERC also assured the D.C. Circuit that Jersey Central Power & Light Co. v. Federal Power Comm'n, 319 U.S. 61, 73 (1943), supported preemption. Opn. at 28-29, Pet. App. C-30 to C-32. The Supreme Court in Jersey Central concluded that some electrons of the utility flowed in interstate commerce, but it noted "that although a company may be a public utility under subsection (e), all of its transactions do not thereby fall under the regulatory power of the Commission" (emphasis added). 319 U.S. at 73; see 1947 Hearings, at 553-554. Pet. App. M-29. Indeed, the Court in Jersey Central stressed that § 201(a), which limits FERC jurisdiction to activities not regulated by the states, "is directed to generation, transmission and sale ..." of electricity (emphasis added). 319 U.S. at 74. The Court below, in direct conflict, declined to apply § 201(a) to transmission.

6. FERC's, and subsequently the D.C. Circuit's, reliance on FP&L and Jersey Central to justify FERC's preemption of retail

transmission, stands in stark contrast to repeated statements, some under oath, by the FPC that FP&L and Jersey Central have no relevance to the states' jurisdiction over intrastate rates and services.

In 1947, after Jersey Central prompted a proposal by state commissions to amend the Federal Power Act, the FPC testified the amendment was unnecessary, assuring Congress that "regulation of retail rates and local services is left to the states by the present act even where the energy moves in interstate commerce" (emphasis added). 1947 Hearings, Testimony of FPC Chairman Nelson Smith, at 336, Pet. App. N-14.[9]

In 1967, after the Fifth Circuit decision in FP&L, FERC testified that a proposed amendment to protect state jurisdiction was unwarranted because "the accounting situation (such as the one in FP&L) differs from rate jurisdiction ....", 1967 Hearings, Testimony of FPC Chairman Lee C. White, at 125, Pet. App. H-15. Moreover, FERC stated in its brief to the Supreme Court in FP&L that an affirmance of its order would only empower it to order FP&L interconnection (§ 202), review mergers and financing (§§ 203, 204) and regulate wholesale rates (§§ 201(b), 205) (FERC FP&L Br., 23, 24, Pet. App. O-3 to O-4). Citing FPC v. Southern Cal., 376 U.S. at 210-216, and the FPA's legislative history, FERC readily acknowledged that it could not regulate retail matters (FERC FP&L Br., 21, 31, Pet. App. O-2, O-10). Contrast such assurances with FERC's insistence in this case that FP&L supports FERC preemption of all unbundled transmission (FERC D.C. Circuit Br.).

7. In ignoring FERC's inconsistency regarding Florida Power and Jersey Central, the D.C. Circuit lost sight of this Court's recent teaching that a federal agency's prior assurances to Congress are, indeed, relevant to subsequent jurisdictional disputes. Food and Drug Administration v. Brown and Williamson Tobacco Corp., ___ U.S. ___, 120 S. Ct. 1291, 1312-1314 (2000). The D.C. Circuit also failed to apply the doctrine of judicial estoppel, in conflict with decisions by other circuits. That is, FERC, having taken the position in its Brief in Florida Power & Light that Florida Power & Light and Jersey Central do not preempt state jurisdiction, is estopped from arguing the opposite. Iowa Utilities Board v. Federal Communications Comm'n, 219 F.3d 744, 756 (8th Cir. 2000). In any event, the D.C. Circuit's decision misreads Florida Power and Jersey Central. Neither decision supports FERC preemption of retail transmission.

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[9] House of Representatives Report No. 1318 (1935), at 8, stated that "the [Federal Power] Commission is given no jurisdiction over local rates even where the electric energy moves in interstate commerce" (emphasis added).

8. The D.C. Circuit's conclusion that all electricity transmissions are interstate renders meaningless FPA §§ 201(a), (b), (c), § 205 and § 212(h) and ignores 201(c)'s limitation on 201(b) (see American Textile Mfrs. Inst. v. Donovan, 452 U.S. 490, 513 (1981)) [all parts of a statute should be afforded meaning]; Schreiber v. Burlington Northern, Inc., 472 U.S. 1, 8 (1985) [all parts of a statute should be read in pari materia]).

Section 205 allows FERC to regulate only "the transmission or sale of electric energy subject to the jurisdiction of the Commission" (emphasis added). Section 201(a) provides that federal jurisdiction shall "extend only to those matters which are not subject to regulation by the states." The Supreme Court has held that "[§ 201(a)'s] limitation is directed at ... transmission and sale ...." Jersey Central, 319 U.S. at 74-75. If §§ 205 and 201(a) and Jersey Central leave any doubt that FERC cannot preempt state regulation of retail transmissions from generators to customers in the same state (which are most transmissions), § 201(b) and (c) -- together -- state that FERC's jurisdiction shall apply only to the transmission of electric energy "transmitted from a State and consumed at any point outside thereof" (emphasis added) (§ 201(c)).

Congress would not have specified that FERC's transmission jurisdiction was limited to energy "transmitted from a state and consumed at any point outside thereof" (FPA § 201(c)) if it intended FERC to regulate the transmission of all energy. When the term "interstate commerce" in § 201(b) is read with § 201(c)'s definition of interstate commerce, as it must be, FERC preemption must be rejected because, having jurisdiction only of the transmission of electricity "transmitted from a state and consumed at any point outside thereof" (§ 201(c)), FERC cannot preempt state regulation of transmission from a generator to a retail customer in the same state.[10]

9. FERC's position runs contrary not only to the FPA as enacted in 1935, but to subsequent amendments added in 1992. Section 212(h) provides that "[n]othing in this subsection shall affect any authority of any State or local government under State law concerning the transmission of electric energy directly to an ultimate consumer." Thus, Congress not only expressly prohibited FERC from regulating matters, such as retail transmission, that were being regulated by the states in 1935 (§ 201(a)), and prohibited FERC from regulating the transmission of electricity from a generator to a retail customer in the same state (§ 201(b) and (c)), but it has recently declared that no provision in the subsection should be read as affecting the authority of any state over the transmission of electric energy to retail customers (§ 212(h)). The Panel's deference to FERC's position that 201(b) allows it to override all state laws regarding retail transmission directly conflicts with 212(h)'s unequivocal directive.

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[10] FERC essentially conceded this point in acknowledging that its preemption decision rendered § 201(c) nugatory, except for Alaska, Hawaii and Texas, (FERC D.C. Circuit brief at 67).

10. FERC's position that all transmission is subject to its jurisdiction also broadsides the admitted purpose of the FPA, which was to fill the "Attleboro gap" (the regulation of interstate transmission and sale of electricity). This Court has held that Congress adopted the test developed in Attleboro. FPC v. Southern California Edison Co., 376 U.S. at 214. The Attleboro test clearly would have allowed states to control retail intrastate transactions, including transmission to retail customers. Indeed, the states regulated such sales in 1935 and thereafter.

11. The D.C. Circuit's conclusion that FERC may preempt state jurisdiction over intrastate retail transmissions conflicts with Federal Power Comm'n v. Southern Cal. Edison Co, 376 U.S. 205, 215 ["Congress meant to draw a bright line easily ascertained, between state and federal jurisdiction, making unnecessary such case-by-case analysis"], and the recent decision in Northern States Power Co. v. Federal Energy Regulatory Comm'n, 176 F.3d 1090, 1096 (8th Cir. 1999), rehearing denied, 1999 U.S. App. LEXIS 23493 (8th Cir. 1999), cert. denied, 120 S. Ct. 1221, ___ U.S. ___ (2000) [FERC's "attempt to regulate the curtailment of electric transmission on native/retail consumers is unlawful" under the "bright line"].

12. Rather than analyze §§ 201(b)(c), 205, 212(h), or the ample evidence of Congressional intent to safeguard state regulation, the Court below pointed to increased interconnection between electric utilities after enactment of the FPA as a basis for upholding FERC preemption. Opn. at 24-26, Pet App. C-26 to C28. As a threshold matter, technological changes after Congress has ruled cannot expand an agency's jurisdiction beyond the limits set by Congress. Chemehuevi Tribe of Indians v. Federal Power Comm'n, 420 U.S. 395, 422-424 (1975); Henry v. Federal Power Comm'n, 513 F.2d 395, 401-402 (D.C. Cir. 1975). Further, although the grid in 1935 was less sophisticated than today, it was sufficiently interconnected to allow 18% of all energy to be imported from other states. 74th

Congress, 1st Session: Senate Report No. 621, at 17, House Report No. 1318, at 7, Pet. App. P-1. Finally, this Court has held that mere interconnection of electric utilities is not enough to defeat state jurisdiction. Arkansas Elec. Coop. Corp. v. Arkansas Public Serv. Comm'n, 461 U.S. 375, 394 (1983).

13. The D.C. Circuit's decision was apparently driven by its view that the electric industry is involved in a transition toward increased competition and that, as the Panel stated, this is an "age of interconnected transmission grids, and ... accompanying technological complexities ...." Opn. at 31, Pet. App. C-34. No basis whatsoever is provided by this claim to infer that Congress' line-drawing can be ignored or to endorse FERC's unauthorized decision to redraw those lines. FERC's preemption of established state regulatory jurisdiction and authority is not in any sense "pro-competitive." Indeed, FERC's position has the effect of discouraging states from implementing retail competition and otherwise serving as regulatory laboratories for national progress. A state that unbundles retail service and thereby provides for competition will lose its jurisdiction over retail transmission service. Retail customers will be deprived of their accustomed state forum and have to seek relief in Washington.

14. Moreover, FERC's attempted seizure of the regulatory authority explicitly conferred on the states by Congress is at odds with this Court's antitrust holdings, the body of law most directly concerned with competition. As the Court held in California v. ARC America Corp., 490 U.S. 93 (1989), federal antitrust laws do not preempt cases brought under applicable state antitrust laws, even though the same alleged conduct may have sufficient impact upon interstate commerce to support a federal antitrust action. The Court noted that there was no explicit Congressional intent to preempt state antitrust laws and that the federal antitrust laws were intended to supplement, not displace, state antitrust laws. The analogy to this case is telling. This

Court should grant certiorari to maintain the jurisdictional dividing lines, just as it did in California v. ARC America Corp. Where a state has exercised its traditional state police powers to protect the welfare of its citizens, State authority should not be overridden, absent explicit preemption by Congress. Hillsborough, supra, California v. ARC America, Corp. supra, see Medtronic v. Lohr, 518 U.S. 484 (1996).

POINT II

THE DECISION THAT FERC MAY PREEMPT STATE REGULATION OF UTILITIES' LOCAL DISTRIBUTION SYSTEMS WHEN ENERGY IS RESOLD CONFLICTS WITH CONGRESS' DIRECTION THAT LOCAL DISTRIBUTION OF ELECTRICITY BE REGULATED BY THE STATES

1. The Court below concluded that § 201(a)'s grant to FERC of authority over wholesale sales overrides § 201(b)(1)'s directive that FERC not regulate local electric distribution systems. Opn. at 34, Pet App. C-37. It thereby allowed FERC to usurp state power to ensure reliable local distribution of electricity over hundreds of thousands of miles of poles, wires and transformers.[11]

The decision conflicts with Connecticut Light & Power v Federal Power Comm'n, 324 U.S. 515, 531 (1945) where this Court rejected a very similar argument. In that case, the Supreme Court held that the nature of the energy being carried over local facilities has no relevance to § 201(b)(1)'s jurisdictional limitation:

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[11] There are 2,509,620 miles of distribution circuits in the continental United States (Edison Electric Institute 1998 survey data).

> [Section 201(b)(1)] is the provision which loomed importantly in the minds and speech of its sponsors, perhaps was necessary to get the bill passed, and is one which the Commission must observe and the courts must enforce .... It does not seem important whether out-of-state energy gets into local distribution facilities. They may carry no energy except extra-state energy and still be exempted under the Act. The test is whether they are local distribution facilities.

Connecticut Power & Light, 324 U.S. at 529, 531.

The Court below, therefore, erred in reasoning that FERC may regulate the rates charged by utilities for their use of local distribution facilities if the energy being transmitted over the local facilities will be resold. See Duke Power Co. v. Federal Power Comm'n, 401 F.2d 930, 939 (D.C. Cir. 1968) [wherein the D.C. Circuit itself noted that § 201(b) was added to remove any possibility of FERC claiming that it could regulate "facilities used for local distribution"]; Wisconsin-Michigan Power Co. v. Federal Power Comm'n, 197 F.2d 472, 477 (7th Cir. 1952) ["'[f]acilities used in local distribution' means facilities used for making resale and distribution to consumers, jurisdiction over which is left to the states"].

2. Admittedly, FERC does have power to define what is a local distribution system. FPC v. Southern California Edison Co., 376 U.S. at 210, n. 6. There is nothing, however, in this Court's decisions that permits FERC to define "local distribution system" and then declare that definition will not be followed. In adopting a definition for purposes of defining the

transmission/distribution split, FERC is bound to respect state jurisdiction over facilities defined as local distribution.

3. The D.C. Circuit's decision that FERC may preempt state regulation of the rates utilities charge for the use of local distribution facilities to complete wholesale sales presents extremely important questions because it renders § 201(b)'s express language meaningless and undermines the states' ability to protect the reliability of local distribution service. FERC's decision allows electric providers to structure their transactions to evade state consumer service protections and rate recovery of costs necessary to ensure reliable local distribution of electricity.

4. Moreover, the Court below ignored Congress' prohibition against sham wholesale transactions; that is, sales to wholesalers that are really disguised sales to retail customers.[12] In contravention of that prohibition, FERC's order specifically sanctions sales under federal transmission tariffs by competitive providers that structure their transactions to make a wholesale purchase at an end-user's meter and then turn around and resell electricity at that meter. In bypassing state local distribution tariffs and charges, such transactions clearly violate Congress' prohibition against sham wholesale sales and its intent that state authority over local electric distribution systems be protected.

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[12] Federal Power Act Section 212(h) states that "[n]o order issued under this chapter shall be conditioned upon or require the transmission of electric energy ... (2) to, or for the benefit of, an entity if such electric energy would be sold by such entity directly to an ultimate consumer unless [exceptions listed not relevant herein]."

POINT III

THE HOLDING THAT FERC MAY PREEMPT STATE AUTHORITY OVER UTILITY COSTS INCURRED UNDER STATE SUPERVISION TO SERVE RETAIL CUSTOMERS VIOLATES CONGRESS' RESERVATION OF RETAIL ELECTRIC JURISDICTION TO THE STATES

1. With regard to utility generation costs that may become unrecoverable ("stranded") when retail customers reduce purchases from utilities due to competition, the Court below reasoned that FERC could "backstop" state decisions on recovery of stranded costs originally reflected in state-jurisdictional retail rates because (1) FERC's assertion of jurisdiction over retail stranded costs did not impinge on state jurisdiction over rates (Opn. at 74-75, Pet. App. C-81 to C-83), and (2) while in most cases, allowing stranded costs related to generation facilities in transmission rates would not be a legitimate exercise of FERC's authority, it was permissible in the "highly unusual circumstances of this case [open access]." Opn. at 75, Pet. App.C-83. The D.C. Circuit's decision runs contrary to the FPC v. Southern Cal. Edison (Colton) "bright line." That bright line over retail service favors state jurisdiction over retail stranded costs.

2. The D.C. Circuit's first rationale fails because federal agencies cannot trivialize state rate decisions by preempting the cost allocations that govern the revenue requirements addressed by the statute. See Louisiana Pub. Serv. Comm'n v. Federal Communications Comm'n, 476 U.S. 355, 373-375 (1986) [FCC could not preempt the states' regulation of intrastate depreciation charges]; see also Nantahala Power and Light Co. v. Thornburg, 476 U.S. 953, 967-969 (1986) [although allocations of wholesale costs by FERC, for the purpose of setting wholesale rates bind the states, the states set retail revenue requirements for retail rate purposes]. The Court below cited Mississippi Industries v. Federal Energy Regulatory Commission, 808 F.2d 1525, 1543-1545 (D.C. Cir. 1987) for the proposition that generation costs can be recovered in FERC-jurisdictional rates, Opn. at 74-75, Pet. App. C-81 to C-82, but inasmuch as that case involved wholesale rates, it does not support a conclusion that FERC may move retail stranded costs into a FERC transmission revenue requirement.

3. The second prong of the Court's reasoning is also incorrect. If utility X spends $500 million on a power plant to serve customers and 10% of the customers opt for generation alternatives, "stranding" $50 million of X's investment, the cause of X's revenue loss, whether it be "open access" (utility X's willingness to carry a competitor's electricity to its customers) or customers installing their own mini-generators, does not transform the stranded generation costs into transmission, or distribution, costs. Indeed, given that an "open" local distribution system is as much of a sine qua non to retail competition as an open transmission system, a percentage of stranded generation costs, under the D.C. Circuit's reasoning, should be considered retail distribution costs, which are regulated solely by the states.

4. The D.C. Circuit concluded that FERC has not interfered with state legislative decisions because it will only act where state commissions have no authority to address stranded cost recovery. Opn. at 76, Pet. App. C-83-C-84. FERC's decision to "backstop" the states denies state legislatures the discretion to design innovative solutions to local problems. For example, a state legislature cannot allow utilities recovery of only a portion of stranded costs in return for a higher rate of return or accelerated return on capital, because of the risk that, notwithstanding the return concessions, FERC will allow recovery of the remaining stranded costs. That FERC may, in

effect, set aside decisions of state legislatures on recovery of stranded costs conflicts with Duquesne Light Co. v. Barasch, 488 U.S. 299 (1989), wherein the Court stated "[i]t cannot seriously be contended that the Constitution prevents state legislatures from giving specific instructions to their utility commissions." 488 U.S. at 313.

5. Finally, the Court below concluded that FERC properly decided it was the "primary forum" for addressing utility generation costs stranded by the formation of municipal utilities because FERC's open access decision makes municipalization feasible and FERC will require a direct nexus between stranded costs and municipalization. Opn. at 82, Pet. App. C-90. The D.C. Circuit, however, never explained why municipalization -- a century old phenomenon by which retail customers of a utility company are served by a newly formed municipal utility -- creates FERC jurisdiction to permit inclusion of stranded retail generation costs in wholesale transmission rates.

6. Because (a) the states, not FERC, are able and willing to address retail customers' rates, and (b) Congress has never indicated a willingness to override state legislative discretion on the rate treatment of costs incurred to serve retail customers, the D.C. Circuit's decision that FERC may preempt state regulation of the rate recovery of "retail stranded costs" raises an extremely important question.

CONCLUSION

As this Court has noted, it is the exclusive province of Congress to rewrite statutes. Louisiana Pub. Serv. Comm'n v. Federal Communications Comm'n, 476 U.S. at 376 (1986). The D.C. Circuit, to the detriment of consumers, has deferred to a FERC reading of the Federal Power Act that renders meaningless several provisions wherein Congress safeguarded state authority over intrastate and retail electric rates and service. The Court should grant the Petition for Certiorari to review the D.C. Circuit's decision upholding FERC's transgressions of its jurisdictional limitations, which significantly undermine the longstanding dual regulatory system that has successfully served our nation's electricity customers for decades.

Respectfully submitted,

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Jonathan D. Feinberg
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Dated: October 11, 2000
Albany, New York

APPENDIX A

Order of United States Court of Appeals for the District of Columbia Circuit filed August 22, 2000

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 97-1715 September Term, 1999

Transmission Access Policy Study Group,
Petitioner

v.

Federal Energy Regulatory Commission,
Respondent

Vermont Department of Public Service, et al.,
Intervenors

Consolidated with 98-1111, 98-1112, 98-1113, 98-1114, 98-1115, 98-1118, 98-1119, 98-1120, 98-1122, 98-1124, 98-1125, 98-1126, 98-1127, 98-1128, 98-1129, 98-1131, 98-1132, 98-1134, 98-1136, 98-1137, 98-1139, 98-1140, 98-1141, 98-1142, 98-1143, 98-1145, 98-1147, 98-1148, 98-1149, 98-1150, 98-1152, 98-1153, 98-1154, 98-1155, 98-1156, 98-1159, 98-1162, 98-1163, 98-1166, 98-1168, 98-1169, 98-1170, 98-1171, 98-1172, 98-1173, 98-1174, 98-1175, 98-1176, 98-1178, 98-1180

BEFORE: Edwards, Chief Judge; Silberman, Williams, Ginsburg, Sentelle, Henderson, Randolph, Rogers, Tatel and Garland, Circuit Judges

ORDER

Upon consideration of petitioners' petition for rehearing en banc, and the absence of a request by any member of the court for a vote, it is

ORDERED that the petition be denied.

Per Curiam

FOR THE COURT:
Mark J. Langer, Clerk
By: s/Robert A. Bonner
Robert A. Bonner
Deputy Clerk

Circuit Judges Silberman and Henderson did not participate in this matter.

Filed On: UNITED STATES COURT OF APPEALS
FOR DISTRICT OF COLUMBIA CIRCUIT
Filed: AUG 22 2000
Clerk

APPENDIX B

Judgment of United States Court of Appeals for the District of Columbia Circuit
filed June 30, 2000

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 97-1715 September Term, 1999

Transmission Access Policy Study Group, et al.
Petitioner

v.

Federal Energy Regulatory Commission,
Respondent

Vermont Department of Public Service, et al.,
Intervenors

Consolidated with 98-1111, 98-1112, 98-1113, 98-1114, 98-1115, 98-1118, 98-1119, 98-1120, 98-1122, 98-1124, 98-1125, 98-1126, 98-1127, 98-1128, 98-1129, 98-1131, 98-1132, 98-1134, 98-1136, 98-1137, 98-1139, 98-1140, 98-1141, 98-1142, 98-1143, 98-1145, 98-1147, 98-1148, 98-1149, 98-1150, 98-1152, 98-1153, 98-1154, 98-1155, 98-1156, 98-1159, 98-1162, 98-1163, 98-1166, 98-1168, 98-1169, 98-1170, 98-1171, 98-1172, 98-1173, 98-1174, 98-1175, 98-1176, 98-1178, 98-1180

On Petitions for Review of Orders of the
Federal Energy Regulatory Commission

Before: SENTELLE, RANDOLPH and TATEL, *Circuit Judges.*

JUDGMENT

These causes came on to be heard on the petitions for review of orders of the Federal Energy Regulatory Commission and were argued by counsel. On consideration thereof, it is

ORDERED and ADJUDGED, by the Court, that the petitions for review are granted in part and denied in part, in accordance with the opinion for the Court filed herein this date.

FOR THE COURT:
Mark J. Langer, Clerk
By: s/Robert A. Bonner
Robert A. Bonner
Deputy Clerk

Date: June 30, 2000

Opinion Per Curiam

UNITED STATES COURT OF APPEALS
FOR DISTRICT OF COLUMBIA CIRCUIT
Filed: JUN 30 2000
Clerk

MANDATE
Pursuant to the provisions of Fed. R. App. Pro. 41(a)
ISSUED: 8/30/00
By: E. Brown
ATTACHED: —Amending Order
—Opinion
—Order on Costs

APPENDIX C

Opinion of United States Court of Appeals for the District of Columbia Circuit
filed June 30, 2000

UNITED STATES COURT OF APPEALS

FOR THE DISTRICT OF COLUMBIA CIRCUIT

Argued November 3, 1999 Decided June 30, 2000

No. 97-1715

TRANSMISSION ACCESS POLICY STUDY GROUP, ET AL.

PETITIONER

V.

FEDERAL ENERGY REGULATORY COMMISSION,

RESPONDENT

VERMONT DEPARTMENT OF PUBLIC SERVICE, ET AL.,

INTERVENORS

Bills of costs must be filed within 14 days after entry of judgment. The court looks with disfavor upon motions to file bills of costs out of time.

(2)Consolidated with
98-1111, 98-1112, 98-1113, 98-1114, 98-1115, 98-1118,
98-1119, 98-1120, 98-1122, 98-1124, 98-1125, 98-1126
98-1127, 98-1128, 98-1129, 98-1131, 98-1132, 98-1134,
98-1136, 98-1137, 98-1139, 98-1140, 98-1141, 98-1142,
98-1143, 98-1145, 98-1147, 98-1148, 98-1149, 98-1150,
98-1152, 98-1153, 98-1154, 98-1155, 98-1156, 98-1159,
98-1162, 98-1163, 98-1166, 98-1168, 98-1169, 98-1170,
98-1171, 98-1172, 98-1173, 98-1174, 98-1175, 98-1176,
98-1178, 98-1180

On Petitions for Review of Orders of the
Federal Energy Regulatory Commission

Sherilyn Peterson, John T. Miller, Jr., Robert C. McDiarmid, Stanley C. Fickle, Sara D. Schotland, Jeffrey L. Landsman, Lawrence G. Malone, Jeffery D. Watkiss, Richard M. Lorenzo, Isaac D. Benkin, Wallace E. Brand, Daniel I. Davidson, Cynthia S. Bogorad, Harvey L. Reiter and *Randolph Lee Elliott* argued the causes for petitioners. With them on the briefs were *William R. Maurer, Ben Finkelstein, David E. Pomper, Ronald N. Carroll, John Michael Adragna, Sean T. Beeny, Wallace F. Tillman, Susan N. Kelly, Craig W. Silverstein, A. Hewitt Rose, Bryan G. Tabler, James D. Pembroke, David C. Vladeck, Robert F. Shapiro, Lynn N. Hargis, Wallace L. Duncan, Richmond F. Allan, Alan H. Richardson, Michael A. Mullett, C. Kirby Mullen, Robert A. Jablon, Sara C. Weinberg, John F. Wickes, Jr., Todd A. Richardson, Brian A. Statz, John P. Cook, Charles F. Wheatley, Jr., Christine C. Ryan, Robert S. Tongren, Joseph P. Serio, Barry E. Cohen, Carrol S. Verosky, Jennifer S. McGinnity, Jonathan D. Feinberg, Charles D. Gray, Robert Vandiver, Cynthia Miller, Helene S. Wallenstein, William H. Chambliss, C. Meade Browder, Jr., Mary W. Cochran, Paul R. Hightower, Brad M. Purdy, Gisele L. Rankin, Robert D.*

Cedarbaum, Edward H. Comer, Edward Berlin, (3)*Robert V. Zener, Elizabeth W. Whittle, James H. McGrew, Donald K. Dankner, Frederick J. Killion, Joseph L. Lakshmanan, Stephen C. Palmer, Michael E. Ward, Steven J. Ross, Marvin T. Griff* and *Thomas C. Trauger. Leja D. Courter, Robert E. Glennon, Jr., Neil Butterklee, Zachary D. Wilson, Sheila S. Hollis, Janice L. Lower* and *James B. Ramsay* entered appearances.

John H. Conway, Deputy Solicitor, Federal Energy Regulatory Commission, and *Timm L. Abendroth* and *Larry D. Gasteiger*, Attorneys, argued the causes for respondent. With them on the brief was *Jay L. Witkin*, Solicitor. *Susan J. Court*, Special Counsel, and *Edward S. Geldermann*, Attorney, entered appearances.

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(4)Before: SENTELLE, RANDOLPH and TATEL, *Circuit Judges.*

Opinion for the Court filed PER CURIAM[1]:

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[1] Following our normal practice in complex cases, we shared the writing of this opinion. Judge Sentelle wrote Section II, Section III, and Section VII. Judge Randolph wrote Section IV, Section VI, and Section VIII. Judge Tatel wrote Section I, Section V, and Section IX.

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Following two notices of proposed rulemaking, the Federal Energy Regulatory Commission issued Orders 888 and 889 on April 24, 1996.[2] Reflecting the Commission's effort to end (7)discriminatory and anticompetitive practices in the national electricity market and to ensure that electricity customers pay the lowest prices possible, these orders represent, as the Commission described in a later order not before us, "the foundation necessary to develop competitive bulk power markets ...." *Regional Transmission Organizations*, Order No. 2000, 65 Fed. Reg. 810, 812 (2000).

Open access is the essence of Orders 888 and 889. Under these orders, utilities must now provide access to their transmission lines to anyone purchasing or selling electricity in the interstate market on the same terms and conditions as they use their own lines. By requiring utilities to transmit competitors' electricity, open access transmission is expected to increase competition from alternative power suppliers, giving consumers the benefit of a competitive market. Most fundamentally, FERC's open access policies, combined with parallel action now occurring on the state level, are intended to create a market in which customers may purchase power from any of a number of suppliers. A municipality or factory in Florida, for example, will no longer have to purchase power from its local utility but instead may seek cheaper power anywhere in the country. A customer in Vermont may purchase electricity from an environmentally friendly power producer in California or a cogeneration facility in Oklahoma.

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[2] *Promoting Wholesale Competition Through Open Access Nondiscriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, FERC Stats. & Regs. ¶ 31,036, 61 Fed. Reg. 21,540 (1996), *clarified*, 76 FERC ¶ 61,009 and 76 FERC ¶ 61,347 (1996) ("Order 888"), *on reh'g*, Order No. 888-A, FERC Stats. and Regs. ¶ 31,048, 62 Fed. Reg. 12,274, *clarified*, 79 FERC ¶ 61,182 (1997), *on reh'g*, Order No. 888-B, 81 FERC ¶ 61,248, 62 Fed. Reg. 64,688 (1997), *on reh'g*, Order No. 888-C, 82 FERC ¶ 61,046 (1998); *Open Access Same-Time Information System and Standards of Conduct*, Order No. 889, FERC Stats. & Regs. ¶ 31,035, 61 Fed. Reg. 21,737 (1996) ("Order 889"), *on reh'g*, Order No. 889-A, FERC Stats. & Regs. ¶ 31,049, 62 Fed. Reg. 12,484 (1997), *on reh'g*, Order No. 889-B, 81 FERC ¶ 61,253 (1997).

All key players in the electricity market have challenged various provisions of Orders 888 and 889. Their claims range from the hypertechnical to arguments that FERC lacks authority to order open access transmission at all. Finding few defects in the orders, we uphold them in nearly all respects.

I. INTRODUCTION

Historically, vertically integrated utilities owned generation, transmission, and distribution facilities. They sold gen-(8)eration, transmission, and distribution services as part of a "bundled" package. Due to technological limitations on the distance over which electricity could be transmitted, each utility served only customers in a limited geographic area. And because of their natural monopoly characteristics, utilities have been heavily regulated at both the federal and state levels.

Since enactment of the Federal Power Act in 1935, the electricity industry has undergone significant change, both economically and technologically. Economies of scale have justified the construction of large (greater than 500 MW) generation facilities, such as nuclear power plants. Technological advances in the 1970s and 1980s have permitted small plants to perate efficiently as well. *See* Notice of Proposed Rulemaking, *Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, FERC Stats. & Regs. ¶ 32,514 at 33,059-60, 60 Fed. Reg. 17,662 (1995) ("Open Access NOPR"). Technological improvements also made feasible the transmission of electric power over long distances at high voltages. *See id.* ¶ 32,514 at

33,060. Alternative power suppliers, such as cogenerators, small power producers, and independent power producers emerged in response to these developments. Constructing and operating generation capacity at prices lower than the embedded generation costs of traditional utilities, these alternative suppliers have created a wholesale market for low-cost power.

The growth of this new wholesale market faced a serious obstacle. "As entry into wholesale power generation markets increased," FERC explained, "the ability of customers to gain access to the transmission services necessary to reach competing suppliers became increasingly important." *Id.* at 33,062. Yet the owners of transmission lines, the traditional utilities that had built the high-cost generation capacity, denied alternative producers access to their transmission lines on competitive terms and conditions. FERC therefore began requiring utilities to file open access transmission tariffs that permitted other suppliers to transmit power over (9)their lines under certain circumstances, such as when a utility sought authorization to merge with another utility or to sell power at market-based rather than cost-based rates.

Then, in 1992, Congress enacted the Energy Policy Act, which amended sections 211 and 212 of the FPA to authorize FERC to order utilities to "wheel" power—*i.e.*, transmit power for wholesale sellers of power over the utilities' transmission lines—on a case-by-case basis. Pub. L. No. 102-486, 106 Stat. 2776, 2915-16 (1992) (codified at 16 U.S.C. §§ 824j-k). FERC "aggressively implemented" amended sections 211 and 212 to " 'facilitate the development of competitively priced generation supply options, and to ensure that wholesale purchasers of electric energy can reach alternative power suppliers and vice versa.' " Open Access NOPR, ¶ 32,514 at 33,064 (quoting Notice of Proposed Rulemaking, *Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, FERC Stats. & Regs.

¶ 32,507 at 32,866, 59 Fed. Reg. 35,274 (1994) ("Stranded Cost NOPR")).

Despite these efforts, a persistent barrier to the development of a competitive wholesale power sale market remained. The Commission found that "utilities owning or controlling transmission facilities possess substantial market power; that, as profit maximizing firms, they have and will continue to exercise that market power in order to maintain and increase market share, and will thus deny their wholesale customers access to competitively priced electric generation; and that these unduly discriminatory practices will deny consumers the substantial benefits of lower electricity prices." Open Access NOPR, ¶ 32,514 at 33,052. Power generators not permitted to use utilities' transmission lines on reasonable terms have no way to transmit their power to customers.

Invoking its authority under sections 205 and 206 of the FPA to remedy unduly discriminatory or preferential rules, regulations, practices, or contracts affecting public utility rates for transmission in interstate commerce, 16 U.S.C. §§ 824d-e, and building on its experience in restructuring the natural gas industry, *see Associated Gas Distribs. v. FERC*, 824 F.2d 981 (D.C. Cir. 1987), the Commission issued Orders (10)888 and 889 to "prevent this discrimination by requiring all public utilities owning and/or controlling transmission facilities to offer non-discriminatory open access transmission service." Open Access NOPR, ¶ 32,514 at 33,052. Orders 888 and 889 mandate what FERC terms "functional unbundling," *i.e.*, separating utilities' wholesale transmission functions from their wholesale electricity merchant functions. Specifically, the orders require utilities to (1) file open access nondiscriminatory tariffs that contain the minimum terms and conditions of nondiscriminatory services prescribed by FERC through its pro forma tariff; (2) take transmission service for their own new wholesale sales and purchases of electric energy under the same terms and conditions as they offer that service to others; (3) develop and maintain a same-time information system that will give potential and existing transmission users the same access to transmission information that the utility enjoys (called the "Open Access Same-Time Information System" or "OASIS"); and (4) state separate rates for wholesale generation, transmission, and ancillary services. *See* Order 888, ¶ 31,036 at 31,635-36.

In requiring utilities to provide open access transmission, FERC acknowledged the dramatic change the orders would bring about, explaining that "[t]he most critical transition issue that arises as a result of the Commission's actions in this rule-making is how to deal with the uneconomic sunk costs that utilities prudently incurred under an industry regime that rested on a regulatory framework and a set of expectations that are being fundamentally altered." Order 888-A, ¶ 31,048 at 30,346. Known as "stranded costs," these "uneconomic sunk costs" are costs that utilities incurred not only with regulatory approval, but with the expectation of continuing to serve their current customers. These costs will become "stranded" when customers take advantage of open access transmission to purchase cheaper power from suppliers other than their historic utilities. Order 888 affords utilities an opportunity to recover stranded costs from their wholesale requirements customers, but only from those customers who use their utility's transmission service to purchase power from new suppliers, and only if the utility can (11)prove that it had a reasonable expectation of continued service to that customer.

After three rehearing orders, the Commission denied any further rehearing. All petitions for review of Orders 888 and 889 were consolidated and transferred to this circuit. We consider these petitions in this opinion. Section II considers challenges to FERC's authority to require utilities to file open access tariffs as a remedy for undue discrimination. Section III evaluates FERC's conclusion that it lacked jurisdiction to order retail unbundling yet has jurisdiction over transmission where state commissions have unbundled retail sales. Section IV addresses FERC's authority to require nonpublic utilities to provide reciprocal open access transmission service. Section V considers challenges to Order 888's stranded cost recovery provisions. Section VI evaluates petitioners' arguments relating to credits for customer-owned facilities and behind-the-meter generation. Section VII addresses discounting, interface allocation, and liability. Section VIII evaluates other arguments relating to the terms and conditions of the pro forma tariff. Section IX assesses FERC's compliance with the National Environmental Policy Act and the Regulatory Flexibility Act.

In the end, we affirm the orders in all respects except two: we remand for FERC to explain its treatment of energy costs in the stranded cost market option (Section V.A.5.c) and to provide a reasonable cap on contract extensions under existing customers' right-of-first-refusal (Section VIII.E).

II. FERC'S AUTHORITY TO REQUIRE OPEN ACCESS

Although FERC asserts that "mounting claims of undue discrimination in transmission access" prompted its movement toward open access, the open access requirement of Order 888 is premised not on individualized findings of discrimination by specific transmission providers, but on FERC's identification of a fundamental systemic problem in the industry. Generally, those entities that own or control interstate transmission facilities are vertically-integrated public utilities that also generate and sell electricity. In its 1995 (12)notice of proposed rulemaking, FERC observed that there were at that time approximately 328 public utilities, marketers, and wholesale generation entities with transmission needs, and that approximately 137 of those owned or controlled the transmission facilities. *See* Open Access NOPR, ¶ 32,514 at 33,051. Entry into the transmission market is difficult and restricted, so those utilities that already own transmission

facilities enjoy a natural monopoly over that field. The transmission-owning utilities can use their position to favor their own generated electricity and to exclude competitors from the market, whether by denying transmission access outright, or by providing transmission services to competitors only at comparatively unfavorable rates, terms, and conditions. Utilities that own or control transmission facilities naturally wish to maximize profit. The transmission-owning utilities thus can be expected to act in their own interest to maintain their monopoly and to use that position to retain or expand the market share for their own generated electricity, even if they do so at the expense of lower-cost generation companies and consumers.

Even before Order 888, some transmission-owning utilities voluntarily opened their transmission facilities to third party suppliers and purchasers of electricity; and FPA § 211 explicitly gives FERC the authority to order involuntary wheeling on a case-by-case basis. The Commission decided, however, that relying upon voluntary arrangements and § 211 orders would not remedy the fundamentally anti-competitive structure of the transmission industry. Instead, the Commission concluded, such a piecemeal approach would result in an inefficient "patchwork" of transmission systems nationwide. "The ultimate loser in such a regime is the consumer." Open Access NOPR, ¶ 32,514 at 33,071.

As an alternative, the Commission interpreted the anti-discrimination language of FPA §§ 205 and 206, 16 U.S.C. §§ 824d, 824e (1994), as giving it the authority to impose open access as a generic remedy for its findings of systemic anti-competitive behavior. Invoking that broad authority, in Order 888, FERC requires every transmission-owning public utility within FERC's jurisdiction to file an Open Access (13)Transmission Tariff (OATT) containing minimum terms and conditions for non-discriminatory service and to take transmission service for their own wholesale sales and purchases of electric energy under those filed OATTs. In other words, this order requires the public utilities to provide the same transmission services to anyone purchasing or selling wholesale power—other public utilities, federal power suppliers and marketers, municipalities, cooperatives, independent power producers, qualifying facilities, or power marketers—as they provide to themselves. The Board of Water, Light and Sinking Fund Commissioners of the City of Dalton (Dalton) operates a municipally-owned utility system which provides electric power to residential, commercial, and industrial consumers in the city of Dalton, Georgia. Dalton obtains transmission services from the Georgia Integrated Transmission System (ITS), which it owns along with public utility George Power Company (GPC) and two other utilities that are not subject to FERC's jurisdiction, and which GPC operates according to the terms of various filed agreements. Puget Sound Energy, Inc. (Puget) is a public utility in the Pacific Northwest, where Bonneville Power Administration, which is not a public utility subject to Order 888's requirements,[3] (14)dominates the electricity transmission market. These two industry petitioners challenge the open access

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[3] Bonneville Power Administration (BPA) "is a power marketing agency in the Pacific Northwest that markets power from thirty federal hydroelectric projects constructed and operated by the Corps of Engineers and the Bureau of Reclamation." *In re Bonneville Power Administration, Power Sale and Transmission Rates*, 54 F.E.R.C. ¶ 62,143 (1991). In Order 888, FERC concluded that BPA is not a public utility as defined by Federal Power Act (FPA) § 201(e), and thus is not subject to Order 888's requirements. Order 888, ¶ 31,036 at 31,858. FERC admitted, however, to three circumstances under which it might review BPA's transmission access and pricing policies: (1) if BPA files an open access tariff for review and confirmation under the Northwest Power Act and asks FERC to find that the tariff meets FERC's open access policies; (2) to the extent that BPA "is a transmitting utility subject to a request for mandatory transmission services" under FPA § 211; and (3) to the extent that BPA receives open access transmission from a public utility and is thereby subject to the reciprocity provision in that public utility's pro-forma tariff. *Id.*

requirement of Order 888 on various statutory, constitutional, and other grounds.

Turning first to the FPA itself, Puget and Dalton argue that §§ 205 and 206 do not give the Commission the authority to order open access as a generic remedy; and even if the FPA does give the agency such authority, FERC has failed to satisfy the statutory requirements for invoking it. Dalton also argues that Order 888 itself violates the FPA by discriminating against transmission facility owners who have invested in those assets. Shifting to constitutional concerns, Puget and Dalton, along with amicus curiae Pacific Legal Foundation, maintain that Order 888 violates the Takings Clause of the Fifth Amendment. Finally, Dalton argues that the open access requirements of the OATT interfere with the antitrust conditions of outstanding nuclear licenses, and thus are unlawful. While we consider each of these challenges separately,[4] we hold that Order 888's open access requirement is authorized by and consistent with the FPA and the Takings Clause. We conclude also that Dalton has not yet suffered injury from the alleged conflict between open access and the nuclear license antitrust conditions, and that its complaint on that issue is therefore not yet ripe for judicial review.

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[4] The Commission and various intervenors on its behalf argue extensively against our jurisdiction over these issues on the grounds that the petitioners failed, in various ways, adequately to raise their concerns before the agency and to preserve the issues for judicial review. Upon careful review of the record, we can safely conclude without further elaboration that these jurisdictional arguments are without merit, that the Commission has had ample notice and opportunity to address all of the petitioners' various statutory, constitutional, and other challenges to Order 888's open access requirement, and that we have jurisdiction to consider these issues.

A. *Statutory Challenges: FPA §§ 205 and 206*

Section 205 of the FPA broadly precludes public utilities, in any transmission or sale subject to FERC's jurisdiction, from "mak[ing] or grant[ing] any undue preference or advantage to (15)any person or subject[ing] any person to any undue prejudice or disadvantage...." 16 U.S.C. § 824d(b). Section 206 of the FPA further provides in relevant part that

> [w]henever the Commission, after a hearing had upon its own motion or upon complaint, shall find that any rate, charge, or classification, demanded, observed, charged, or collected by any public utility for any transmission or sale subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order.

16 U.S.C. § 824e(a). The statutory issues before us are whether these provisions give FERC the authority to order involuntary wheeling as a generic remedy, and if they do, whether FERC satisfied the procedural and evidentiary requirements imposed by these provisions.

1. *§§ 205 and 206 and* Otter Tail Power Company

The Commission did not write on a blank slate when it interpreted FPA §§ 205 and 206 as giving it the authority to order involuntary wheeling as a generic remedy for systemic anti-competitive behavior. Puget and Dalton argue principally that the

Supreme Court's decision in *Otter Tail Power Co. v. United States*, 410 U.S. 366 (1973), controls the disposition of this issue. *Otter Tail* was an antitrust case in which the Supreme Court addressed whether the district court could require Otter Tail Power Company to wheel power for its competitors as a remedy for monopolistic practices. Contrary to the company's arguments, the Supreme Court concluded that the district court's order did not impermissibly conflict with the authority of the Federal Power Commission, FERC's predecessor, because the agency did not have the power itself to order involuntary wheeling under Part II of the FPA, which includes §§ 205 and 206. Puget and Dalton (16)cite various circuit court precedents, including one from this circuit, as construing *Otter Tail* to prevent the Commission from ordering involuntary wheeling as a generic remedy. *See, e.g., Florida Power & Light Co. v. FERC*, 660 F.2d 668 (5th Cir. Unit B Nov. 1981); *New York State Electric & Gas Corp. v. FERC*, 638 F.2d 388 (2d Cir. 1980); *Richmond Power & Light v. FERC*, 574 F.2d 610 (D.C. Cir. 1978). Finally, Puget and Dalton note that subsequent to *Otter Tail*, Congress enacted FPA § 211, 16 U.S.C. § 824j, giving FERC the authority to impose open access on a case-by-case basis to remedy a broad range of problems. The petitioners argue that, if FPA §§ 205 and 206 authorize the Commission to impose open access, and if *Otter Tail* does not prohibit such action, then there was no reason for Congress to enact § 211.

In response, the Commission contends that we should not read *Otter Tail* as limiting its authority under FPA § 206 to remedy discriminatory behavior, since *Otter Tail* was an antitrust case and not an undue discrimination case. The Commission also maintains that the circuit court cases cited by the petitioners are not on point and do not prohibit a generic open access remedy. The Commission points instead to our decision in *Associated Gas Distributors v. FERC*, 824 F.2d 981, 998 (D.C. Cir. 1987) (*AGD*), in which we upheld a similar open access transportation requirement imposed by FERC on natural gas transmission, as the controlling precedent. Finally, FERC argues that Congress enacted FPA § 211 to broaden its already existing authority to order involuntary wheeling, as FPA §§ 205 and 206 authorize such action only as a remedy for undue discrimination.

We agree with FERC that our decision in *AGD* controls the disposition of this issue. In *AGD*, we reviewed a FERC order imposing open access conditions on pipelines transporting natural gas. *See* 824 F.2d at 997-1001. Considering arguments quite similar to those made by the petitioners here, we concluded that *Otter Tail* does not constrain FERC from mandating open access where it finds circumstances of undue discrimination to exist. *See id.* at 998-99. Turning to relevant circuit precedent, we construed *Richmond Power & Light* as supporting only the proposition that a refusal to (17)provide transmission services to another utility was not *per se* unduly discriminatory and we noted that the court in *Florida Power & Light* expressly left open the question of whether FERC could impose open access conditions as a remedy for anti-competitive behavior. *See id.* at 999. Further, we pointed out that our reading of *Richmond* is consistent with other precedent, specifically *Central Iowa Power Coop. v. FERC*, 606 F.2D 1156 (D.C. Cir. 1979), in which we upheld FERC's use of its authority to prevent undue discrimination to condition its approval of a power-pooling agreement upon removal of membership criteria which denied certain privileges to some but not all participants. *See AGD*, 824 F.2d at 999. Indeed, in *AGD*, we noted that open access relies upon the very same principles that we upheld in *Central Iowa. See id.* Although *AGD* addressed open access under the anti-discrimination provisions of the Natural Gas Act (NGA) rather than FPA §§ 205 and 206 , we have repeatedly recognized the similarity of the two statutes and held that they should be interpreted consistently. *See Environmental Action v. FERC*, 996 F.2d 401, 410 (D.C. Cir. 1993); *Tennessee Gas Pipeline Co. v. FERC*, 860 F.2d 446, 454 (D.C. Cir. 1988); *see also Arkansas La. Gas Co. v. Hall*, 453 U.S. 571, 577 n.7 (1981). Thus, *AGD* counsels the conclusion that, while *Otter Tail* may represent a general rule that FERC's authority to order open access is limited, the FPA, like the NGA, makes an exception to that rule where FERC finds undue discrimination.

Moreover, as in *AGD*, the deferential standard of *Chevron U.S.A. Inc. v. Natural Resources Defense Council*, 467 U.S. 837 (1984), governs our review of FERC's interpretation of FPA §§ 205 and 206. *See AGD*, 824 F.2d at 1001. If we agreed with Puget and Dalton that the Supreme Court's *Otter Tail* opinion dictates a particular construction of §§ 205 and 206, then the Commission's contrary interpretation would not be entitled to *Chevron* deference. *See Maislin Indus., U.S., Inc. v. Primary Steel, Inc.*, 497 U.S. 116, 131 (1990) ("Once we have determined a statute's clear meaning, we adhere to that determination under the doctrine of *stare decisis*, and we judge an agency's later interpretation of the statute against (18)our prior determination of the statute's meaning."). But having concluded that *Otter Tail* does not govern the disposition of this case, we are faced solely with considering the validity of FERC's interpretation of the FPA, a statute that the Commission administers. In *AGD*, we concluded that FERC reasonably interpreted the NGA's ambiguous anti-discrimination provisions as giving it broad authority to remedy unduly discriminatory behavior through a generic open access requirement. *See AGD*, 824 F.2d at 1001. Given the FPA's similar language, we can only reach the same conclusion with respect to Order 888. For all of these reasons, we find that the Commission has the authority under FPA §§ 205 and 206 to require open access as a generic remedy to prevent undue discrimination.

2. *§ 206(a) Procedural and Evidentiary Requirements*

Puget and Dalton next argue that, even if FPA §§ 205 and 206 authorize FERC to impose open access generically, § 206(a) imposes certain procedural and evidentiary requirements for action which the Commission failed in two separate but related ways to satisfy. First, the petitioners claim that FPA § 206(a) requires substantial evidence of contemporaneous "unjust, unreasonable, unduly discriminatory or preferential" behavior before the Commission can act. The Commission made no finding of discrimination or monopoly control on the part of Georgia Power Company or Puget. None of the applications or complaints filed with the Commission accused these petitioners of unduly discriminatory or anti-competitive behavior. Instead, the Commission premised Order 888 on a generic finding that public utility holders as a group have sufficient monopoly power over the transmission of electricity to engage in unduly discriminatory and anti-competitive practices, and that this condition will worsen in the future. To support its finding, the Commission relied upon unsubstantiated allegations of discriminatory conduct in public comments, its own experience in reviewing applications and complaints, and its own understanding of the incentives for monopolists to behave discriminatorily.

(19)Puget and Dalton additionally assert that FPA § 206(a) requires that the requisite findings of undue discrimination be made in the context of a hearing. Although they concede that a rulemaking proceeding can satisfy the statute's hearing requirement, Puget and Dalton maintain that the rulemaking proceeding nevertheless must clearly identify the challenged activities and actors, and give the accused actors the opportunity to demonstrate that their activities were not unlawful. The petitioners protest that the Commission's notice-and-comment rulemaking process did not afford them such opportunity.

FERC claims the discretion under *NLRB v. Bell Aerospace Co.*, 416 U.S. 267, 293 (1974), to choose between rulemaking and case-by-case adjudication; and FERC contends that its generic rulemaking process fully satisfied the requirements of FPA § 206(a). FERC concedes that it relied upon general

findings of systemic monopoly conditions and the resulting potential for anti-competitive behavior, rather than evidence of monopoly and undue discrimination on the part of individual utilities. Citing our opinion in *Wisconsin Gas Co. v. FERC*, 770 F.2d 1144, 1166 (D.C. Cir. 1985), however, FERC maintains that such findings are sufficient to substantiate its decision to impose the open access requirement. Finally, FERC observes that we rejected these same arguments in *AGD*. *See* 824 F.2d at 1008 (citing *Wisconsin Gas*, 770 F.2d at 1165-68).

Again, we must agree with the Commission. In *American Public Gas Ass'n v. FPC*, we held that the Commission could exercise its authority under NGA § 5(a), the provision parallel to FPA § 206, through rulemaking as well as adjudication. *See* 567 F.2d 1016, 1064-67 (D.C. Cir. 1977); *See also Wisconsin Gas*, 770 F.2d at 1153 (articulating the *American Public Gas* holding). Congress subsequently ratified the *American Public Gas* holding when it enacted the Department of Energy Organization Act, 42 U.S.C. § 7173(c) (1994). *See Wisconsin Gas*, 770 F.2d at 1153 n.8 (acknowledging the Act). That statute provides that "the establishment of rates and charges under the Federal Power Act [16 U.S.C. 791a et seq.] or the Natural Gas Act [15 U.S.C. 717 et seq.], may be conducted by (20)rulemaking procedures." 42 U.S.C. § 7173(c) (brackets in original). By passing a statute adopting the holding of *American Public Gas*, and explicitly applying that rule to the FPA as well as the NGA, Congress signaled its intent that the hearing requirements of NGA § 5(a) and FPA § 206(a) be interpreted similarly.

Interpreting the hearing requirement of NGA § 5(a), we have said that, while the Commission cannot rely solely on "unsupported or abstract allegations," the agency is also not required to make "specific findings," so long as the agency's factual determinations are reasonable. *See Wisconsin Gas*, 770 F.2d at 1158. In *AGD*, we applied *Wisconsin Gas* in holding that the Commission was not required to make specific findings that individual rates charged by individual pipelines were unlawful, or to offer empirical proof for all the propositions upon which its order depended, before promulgating a generic rule to eliminate undue discrimination. *See AGD*, 824 F.2d at 1008-09. Upon comparison of the order considered in *AGD* with Order 888, if anything, FERC more thoroughly documented the reasons for its actions in Order 888 than in the earlier natural gas order.

Puget claims that *AGD* and *Wisconsin Gas* are distinguishable, and that this case is governed by *Electricity Consumers Resource Council v. FERC*, 747 F.2d 1511 (D.C. Cir. 1984), in which we reversed FERC's adoption of a rate based on an economic theory in the absence of a discussion of the practical applications of that theory. *See* 747 F.2d at 1514. As the *AGD* court recognized, however, the court in *Electricity Consumers* was persuaded that the Commission had distorted the economic theory it claimed to apply. *See AGD*, 824 F.2d at 1008. Just as the pipelines in *AGD* did, Puget has failed to articulate exactly how FERC has distorted the theories on which it relies in Order 888. Additionally, the *AGD* court rejected the idea that "*Electricity Consumer*'s reference to 'economic theory' was intended to invalidate agency reliance on generic factual predictions merely because they are typically studied in the field called economics." *Id.* Following the rationale of *Wisconsin Gas* and *AGD*, we conclude that (21)FERC has satisfied the requirements for invoking its authority under FPA § 206(a).

3. *Discriminatory Effect of Order 888*

Dalton charges that, even if the FPA permits FERC to impose involuntary wheeling generally, the open access requirement of Order 888 causes rather than remedies discrimination, and therefore violates FPA § 206(a)'s express requirement that FERC act against undue discrimination. Specifically, Dalton and the other non-jurisdictional owners of the Georgia ITS facilities invested millions of dollars in those facilities in order to use the

facilities each owns and receive reciprocal open access transmission services from the other owners. Under the Open Access Transmission Tariff (OATT), other customers do not have to make such investments to use the Georgia ITS facilities. FERC responds that Order 888 does not unduly discriminate between old and new customers of integrated transmission systems like the Georgia ITS; and that if Dalton has evidence that the tariff results in undue discrimination in its individual circumstances, Dalton remains free to file a petition under FPA § 206 for redress, and FERC will consider its claim.

FERC's conclusion that its open access requirement is not unduly discriminatory is subject only to arbitrary and capricious review. *See* 5 U.S.C. § 706(2)(A) (1994); *Sithe/Independence Power Partners, LP v. FERC*, 165 F.3d 944, 948 (D.C. Cir. 1999); *Union Pacific Fuels, Inc. v. FERC*, 129 F.3d 157, 161 (D.C. Cir. 1997). We conclude that FERC has adequately explained why its open access requirement is not unduly discriminatory. Relying upon extensive commentary as well as its own experiences, FERC concluded that, as a general matter, transmission industry conditions were conducive to discriminatory practices and anti-competitive behavior, such that case-by-case adjudication could not adequately address the problem. FERC also recognized that its generic findings may have exceptions, and thus that Order 888 may in individual circumstances have a different result than that intended. Therefore, Order 888 does not preclude facilities owners the opportunity to argue their particular circum-(22)stances in their OATT filings or, as with Dalton, in their own petitions for relief under FPA § 206(a). Rather, Order 888 merely shifts from a regulatory norm in which a user of transmission services must demonstrate to FERC an individualized need for open access to one in which a provider of transmission services must present to FERC individualized circumstances requiring relief from open access. As the petitioners have a mechanism by which they can seek relief for their particular concerns, we find nothing arbitrary or capricious about FERC's conclusion that its approach to open access is not unduly discriminatory.

In another stab at demonstrating the discriminatory effect of Order 888's open access requirement, Dalton alerts us to an agreement entered into between it and Georgia Power Company (GPC) in partial implementation of antitrust conditions contained in operating licenses issued by the Nuclear Regulatory Commission for jointly owned nuclear facilities connected to the Georgia ITS. Those antitrust conditions require GPC to provide Dalton with transmission services until the nuclear licenses expire, long after the ITS Agreement terminates. Dalton alleges that limitations imposed by Order 888 on Dalton's rights upon termination of the ITS Agreement are inconsistent with GPC's obligations under the nuclear licenses, and that the interference will result in discrimination against Dalton. FERC maintains that it agreed in addressing GPC's Order 888 compliance filing to treat the ITS Agreements separately.

Ultimately, Dalton has offered no present injury from the alleged conflict, so this issue is not ripe for review. Dalton will only be injured if, upon termination of the ITS Agreement, Order 888 interferes with Dalton's right to transmission services. Dalton's own argument suggests as much, observing that FERC "left to GPC the decision whether it 'must, but cannot, comply with separate orders' of NRC and FERC and whether it will present evidence of such conflict to either Commission," and complaining that even if GPC does act, "the orders under review provide no assurance that the competitive transmission and other service rights provided by the nuclear licenses will be respected under the OATT." Br. (23)of Petitioner Dalton at 23 (quoting Order 888-A, ¶ 41,048 at 30,452). In short, GPC and FERC are still in the process of determining whether the antitrust provisions even conflict with Order 888, as well as how to deal

with any such inconsistency.[5] Accordingly, this issue is not appropriate for judicial review at this time.

B. *Constitutional Challenge: Fifth Amendment Takings Clause*

Puget and amicus curiae Pacific Legal Foundation (Pacific) contend that Order 888 violates the Takings Clause of the Fifth Amendment. These petitioners maintain that Order 888's open access requirement engineers a "taking" in two ways: First, that FERC's open access requirement effects a regulatory taking by arbitrarily changing pricing methodology in a way that excessively deprives transmission owners of their investments in facilities; and, second, that the open access requirement allows a physical invasion, a permanent physical occupation, by taking away the transmission owners' right to exclude competitors from their transmission property. We cannot grant relief on either ground.

When the action of the federal government effects a "taking" for Fifth Amendment purposes, there is no inherent constitutional defect, provided just compensation is available. At bottom, both of the petitioners' Fifth Amendment claims turn not on whether open access effects a taking, but whether FERC's cost-based transmission pricing policies in the end provide just compensation. The remedy of just compensation is not within our jurisdiction but that of the United States Court of Federal Claims, under the Tucker Act, 28 U.S.C. § 1491. *See Bell Atlantic Tel. Cos. v. Federal Communications Comm'n*, 24 F.3d 1441, 1444 n.1 (D.C. Cir. 1994); *Railway Labor Executives' Ass'n v. United States*, 987 F.2d 806, 815-16 (D.C. Cir. 1993).

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[5] GPC's management of the Georgia ITS is subject to the direction of a committee that includes Dalton representatives.

We recognize that our jurisdiction to review an agency's construction of a statute necessarily involves an exercise of (24)the policy of avoiding constitutional issues where possible, even though the issues may concern arguable takings amenable to Tucker Act remedy, "when 'there is an identifiable class of cases in which application of a statute will necessarily constitute a taking.' " *Bell Atlantic*, 24 F.3d at 1445 (D.C. Cir. 1994) (quoting *United States v. Riverside Bayview Homes, Inc.*, 474 U.S. 121, 128 n.5 (1985)). We need not decide whether this case falls within that category, however, because even if it did, any takings problem created by Order 888 does not raise such significant constitutional doubt as to require us to construe the FPA to prohibit FERC from ordering open access. If there is a taking, and a claim for just compensation, then that is a Tucker Act matter to be pursued in the Court of Federal Claims, and not before us.

III. FEDERAL VERSUS STATE JURISDICTION OVER TRANSMISSION SERVICES

Vertically integrated utilities use their own facilities to generate, transmit, and distribute electricity to their customers. Traditionally, the customer paid one combined rate for both the power and its delivery, thus the industry refers to such sales as "bundled." To the extent that bundled sales are made directly to the end user of the electricity, they are also recognized as retail sales. Utilities may also sell the electricity they generate at wholesale to other utilities or other resellers of power, which then resell that power to their own customers. Thus, the same utility may use its facilities to serve both retail and wholesale customers. Vertically integrated utilities use their transmission facilities to move electricity over long distances, and use local distribution lines to deliver the electricity to the end user.

Even before Congress enacted the FPA, the Supreme Court held that states could not regulate wholesale sales of electricity.

See Public Utils. Comm'n of R.I. v. Attleboro Steam & Elec. Co., 273 U.S. 83 (1927). A few years leter in 1935, Congress included in the FPA a provision giving the Federal Power Commission, FERC's predecessor agency, the authority to regulate "the sale of [electric] energy at whole-(25)sale," as well as "the transmission of electric energy in interstate commerce." FPA § 201(a), 16 U.S.C. § 824(a) (1994). FERC also limited federal regulation "to those matters which are not subject to regulation by the States," *id.*, and reserved to the states "jurisdiction ... over facilities used for the generation of electric energy or over facilities used in local distribution or only for the transmission of electric energy in intrastate commerce...." FPA § 201(b), 16 U.S.C. § 824(b). Pursuant to these provisions, FERC has regulated wholesale power sales and interstate transmissions, and state agencies have retained jurisdiction over bundled retail transactions, including service issues and the intrastate sale and distribution of electricity through local distribution facilities.

Initially, as most transactions involved either a wholesale or a retail sale, and correspondingly transmission or local distribution facilities, this regulatory division of labor was straight-forward in application. Indeed, in 1935, when Congress enacted the FPA, the networks of high-voltage, long-distance transmission lines which today crisscross the United States did not exist. Instead, vertically integrated utilities individually built facilities sufficient to meet the power needs of their customers. Over time, however, the landscape of the electric industry changed.

Utilities decided to cover demand spikes by sharing power, rather than by building more generation capacity. The transmission grid developed from these arrangements. Eventually, nonutility generators started producing electricity; and power marketers began to buy and resell electricity to other power marketers, utilities, or even directly to consumers. These industry participants do not own transmission lines, so they rely upon the utilities that own such facilities to provide transmission services. In addition to their traditional bundled sales activity, vertically integrated utilities started "unbundling" their own services and developing their own power marketing units to buy and sell electricity at wholesale. Some states even mandate unbundling of retail services. As a result of these changes, facilities once used solely for local distribution of bundled retail sales now engage regularly in (26)unbundled wholesale transmissions and retail delivery as well. Thus, while the electricity world once neatly divided into spheres of retail versus wholesale sales, and local distribution versus transmission facilities, such is no longer the case.

In Order 888, FERC reinterpreted FPA § 201 to accommodate the new industry practices and conditions. FERC left the regulation of bundled retail transmissions to the states, concluding that "when transmission is sold at retail as part and parcel of the delivered product called electric energy, the transaction is a sale of electric energy at retail." Order 888, ¶ 31,036 at 31,781. Nevertheless, FERC asserted jurisdiction over all unbundled retail transmissions, and left to the states only the sales portion of unbundled retail transactions, on the ground that FPA § 201 gives it jurisdiction without qualification over all transmission by public utilities in interstate commerce. *See id.* Also, while acknowledging that FPA § 201(b) explicitly places retail transmissions by "facilities used in local distribution" beyond the Commission's jurisdiction, FERC adopted a seven factor jurisdictional test for determining which facilities fall within that category, and claimed exclusive authority over those that do not. *See id.* at 31,780, 31,784. In the present litigation, eachy of these changes is challenged, with some petitioners claiming that FERC went too far, and others contending that the Commission did not go far enough in asserting jurisdiction.

A. *Bundled Retail Sales*

Several state regulatory commissions complain that FERC exceeded the boundaries of its statutory authority by asserting jurisdiction over unbundled retail transmissions. These state petitioners argue that the plain meaning and history of FPA § 201(a) gives FERC the authority to regulate only transmissions of electricity consumed in a state other than that in which the electricity was generated, if the transmission was not otherwise subject to state regulation. The states historically have regulated retail transmissions as part of bundled retail sales of electricity, while FERC has regulated wholesale transmissions; and the division of regulatory jurisdiction should not change merely because those transac-(27)tions have now been unbundled into separate generation, transmission, and sales components.

Two groups of transmission dependent utilities, TAPS and TDU Systems, and the nation's largest power wholesaler, Enron Power Marketing (collectively the "unbundling and discounting" or "U&D" petitioners), both intervene on the side of FERC with respect to the states' claim, and separately challenge FERC's interpretation of its jurisdiction on different grounds. The U&D petitioners contend that FERC impermissibly limited its jurisdiction by leaving the regulation of bundled retail transmissions to the states. These parties maintain that FERC has the authority to regulate both bundled and unbundled retail transmissions, and that FERC violates FPA § 206 by limiting the scope of Order 888 to the latter. To establish that bulk transmission by utilities is transmission in interstate commerce regardless of whether the power is sold at wholesale or retail, the U&D petitioners cite particularly *FPC v. Florida Power & Light Co.*, 404 U.S. 453 (1972), and *Jersey Central Power & Light Co. v. FPC*, 319 U.S. 61 (1943), two of the cases relied upon by FERC in the Notice of Proposed Rulemaking, ¶ 32,514 at 33,135-42. As further support that FERC's jurisdiction extends to all interstate transmissions, the U&D petitioners offer NGA precedent recognizing FERC's authority over all interstate gas transportation, if not the gas being transported. *See, e.g. FPC v. Louisiana Power & Light Co.*, 406 U.S. 621, 636 (1972); *United Distribution Cos. v. FERC*, 88 F.3d 1105, 1153 (D.C. Cir. 1996) (*UDC*); *Mississippi River Transmission Corp. v. FERC*, 969 F.2d 1215 (D.C. Cir. 1992). These petitioners contend that excluding bundled retail transmissions from the OATT will permit discrimination and give owners a competitive advantage, contrary to the mandate of FPA § 206(a) that FERC eliminate undue discrimination. Accordingly, the U&D petitioners claim that FERC erred when it declined to mandate functional unbundling for an owner's transmissions to bundled retail customers of (1) its own generated power or (2) power purchased at wholesale.

In response to these challenges, FERC maintains that the plain meaning of FPA § 201 gives the Commission jurisdic-(28)tion over all interstate transmissions without qualification, while at the same time limiting jurisdiction over sales to wholesale sales. Relying particularly on *Florida Power & Light* and *Jersey Central Power & Light*, FERC asserts broad jurisdiction over all transmission activities in interstate commerce. As for bundled retail sales, FERC's position is that once the transmission service is bundled with generation and local distribution, it becomes merely a component of the retail sale itself, over which FERC has no jurisdiction. FERC maintains that natural gas jurisprudence is inapplicable because the language of the NGA and FPA differ on this issue, and the natural gas cases turned on the existence of a regulatory gap that does not exist in the electricity field. FERC also asserts that its interpretation of the FPA's jurisdictional grant is entitled to deference under *Chevron U.S.A. Inc. v. Natural Resources Defense Council*, 467 U.S. 837 (1984).

Both FPA § 201(a) and (b) clearly and unambiguously confer upon FERC jurisdiction over the "transmission of electric energy in interstate commerce." FPA § 201(c) further provides that "electric energy shall be held to be transmitted in interstate commerce if transmitted from a State and consumed at any point outside thereof." 16 U.S.C. § 824(c). In both *Florida Power & Light* and *Jersey Central Power & Light*, the Supreme Court considered whether certain indirect transmissions of electrical power across state lines represented transmissions in interstate commerce.

Jersey Central Power & Light involved the transmission of energy generated by Jersey Central in New Jersey. Jersey Central transmitted electricity to the New Jersey transmission facilities of another company, Public Service, which then transmitted the power first to another of its New Jersey facilities, and then on to a facility owned by yet a third company and located in the middle of a body of water separating New Jersey from Staten Island, New York. The third company in the chain then transmitted the energy first to its own facilities in New York, then finally and ultimately to consumers in New York. Jersey Central's own transmission facilities were located solely in New Jersey, and as were (29)the facilities used by Public Service to receive the transmissions from Jersey Central.

The Supreme Court recognized that Jersey Central had no control over the transmissions' destination once the electricity was delivered to Public Service, *see Jersey Central*, 319 U.S. at 65, and that the total flow of electricity from Jersey Central to New York was small. *See id.* at 66. Nevertheless, because some electricity generated by Jersey Central in New Jersey was consumed in New York, the Court upheld FERC's jurisdiction under FPA § 201 over Jersey Central's transmission facilities as utilized for transmissions in interstate commerce. *See id.* at 67. The Court said that, under FPA § 201(a) and (b), FERC's power extends over all facilities "which transmit energy actually moving in interstate commerce." *Id.* at 72. The Court emphasized, however, that "mere connection" of one utility's transmission facilities to those of another transmitting in interstate commerce was insufficient for jurisdiction under FPA § 201. *Id.*

The Court revisited the issue in *Florida Power & Light*, which involved certain Florida and Georgia utilities who voluntarily connected their transmission facilities to coordinate their activities and exchange power as required to meet temporary needs. Like Jersey Central, FP&L's transmission facilities were confined to Florida, and none of FP&L's transmission lines directly connected with those of out-of-state companies. Nevertheless, because FP&L was a member of a group of interconnected utilities, its transmission lines connected with those of other Florida utilities; and the lines of one of those other utilities, Florida Power Corp., interconnected just short of Florida's northern border with those of Georgia Power Co. Records indicated that power transfers between FP&L and Florida Power coincided with transfers between Florida Power and Georgia Power.

In *Jersey Central*, logs of the relevant companies demonstrated at least a dozen occasions when facilities in New York drew power from certain lines at times when Jersey Central was the only supplier of electricity to those lines. *See Florida Power & Light*, 404 U.S. at 459. By way of contrast, (30)there was no similar evidence that power generated by FP&L specifically passed through Florida Power to Georgia Power, with Florida Power serving as a mere conduit. *See id.* At best, company records demonstrated instances when transfers between FP&L and Florida Power occurred at or about the same time as transfers between Florida Power and Georgia Power. *See id.* at 457.

Instead, the Court considered two theories by which FP&L's power could be deemed transmitted across state lines. The first posited a cause and effect relationship by which every flick of a light switch would cause every generator on a multi-state interconnected system to produce some quantity of additional electricity to maintain the system's balance, and thus to transmit electric energy throughout the system and across state lines. The second theory suggested that where the transmission lines of two utilities interconnect, their energy commingles, such that inevitably some energy transmitted by FP&L to Florida Power was then transmitted to Georgia Power and across state lines.

Despite its statement in *Jersey Central* that "mere connection determines nothing," 319 U.S. at 72, the Court relied on the second of these theories to conclude that FP&L's facilities were transmitting energy in interstate commerce, and left open the possible validity of the cause and effect theory. *See* 404 U.S. at 462-63. Writing in dissent, Justice Douglas characterized the Court's opinion as "mean[ing] that every privately owned interconnected facility in the United States ... is within the [Federal Power Commission's] jurisdiction," such that otherwise local utilities would now be subject to the mandates of the federal bureaucracy. *Id.* at 471 (Douglas, J., dissenting).

The Supreme Court has interpreted the language in FPA § 201 regarding FERC's jurisdiction over transmissions in interstate commerce. We are bound by the High Court's dictates to conclude that the FPA gives FERC the authority to regulate the transmissions at issue here, whether retail or wholesale. Even if the Court had not so spoken, however, and even if we independently concluded that the statute's text (31)was less than clear, it is the law of this circuit that the deferential standard of *Chevron U.S.A. Inc. v. Natural Resources Defense Council*, 467 U.S. 837 (1984), applies to an agency's interpretation of its own statutory jurisdiction. *See Oklahoma Natural Gas Co. v. FERC*, 28 F.3d 1281, 1283-84 (D.C. Cir. 1994). As guided by *Chevron*, unless Congress has directly spoken to the contrary, or FERC has unreasonably or impermissibly interpreted the statute, we must defer to the Commission's construction of ambiguous provisions of the FPA. *See Chevron*, 467 U.S. at 842-43. In this age of interconnected transmission grids, and given the accompanying technological complexities, we would be hard pressed to conclude that FERC's interpretation of § 201(c) as giving it jurisdiction over both wholesale and retail transmissions is unreasonable or impermissible.

Nevertheless, we are not persuaded that this conclusion requires FERC to mandate unbundling and assert jurisdiction over all retail transmissions. Just as FPA § 201 gives FERC jurisdiction over transmissions in interstate commerce and sales at wholesale, the statute also clearly contemplates state jurisdiction over local distribution facilities and retail sales. The statute is much less clear about exactly where the lines between those activities are to be drawn. A regulator could reasonably construe transmissions bundled with generation and delivery services and sold to a consumer for a single charge as either transmission services in interstate commerce or as an integral component of a retail sale. Yet FERC has jurisdiction over one, while the states have jurisdiction over the other. FERC's decision to characterize bundled transmissions as part of retail sales subject to state jurisdiction therefore represents a statutorily permissible policy choice to which we must also defer under *Chevron*. Accordingly, we affirm FERC's decisions in Order 888 to assert jurisdiction over unbundled retail transmissions while leaving regulation of bundled retail transmissions to the states.

B. *Local Distribution Facilities*

FPA § 201(b) explicitly excludes from FERC jurisdiction "facilities used in local distribution or only for the transmis-(32)sion of electric energy in intrastate commerce." 16 U.S.C. § 824(b) (1). Historically, wholesale sales have not for the most part involved local distribution facilities. FERC claims that increased unbundling gives resellers the opportunity to reconfigure the wholesale sales so that they might now occur on those facilities which traditionally have been treated as local

distribution facilities. Moreover, FERC's assertion of jurisdiction over the transmission component of unbundled retail sales blurred the line between local distribution facilities and facilities used for transmission in interstate commerce.

In Order 888, FERC claimed exclusive authority over the regulation of facilities which sell and transmit electricity at wholesale to customers who will resell the electricity to end users. With respect to unbundled retail sales, FERC acknowledged that transmissions by "facilities used in local distribution" are beyond the Commission's jurisdiction, while facilities engaged in interstate transmission are subject to FERC jurisdiction under FPA § 201(a). Thus FERC adopted a seven factor jurisdictional test to identify whether a facility is a local distribution facility subject to state jurisdiction or a facility engaged in interstate transmission subject to FERC jurisdiction.[6] In short, under Order 888, when a (33)public utility is engaged in wholesale transmission, FERC has jurisdiction regardless of the nature of the facility; but when the public utility is engaged in unbundled retail transmission, the facts and circumstances will determine whether the facilities are subject to FERC or state jurisdiction.

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[6] The Commission's seven factor test involves evaluating on a case-by-case basis whether the activities of the facilities in question correspond with seven specific indicators of local distribution:

(1) Local distribution facilities are normally in close proximity to retail customers.

(2) Local distribution facilities are primarily radial in character.

(3) Power flows into local distribution systems; it rarely, if ever, flows out.

(4) When power enters a local distribution system, it is not reconsigned or transported on to some other market.

(5) Power entering a local distribution system is consumed in a comparatively restricted geographical area.

(6) Meters are based at the transmission/local distribution interface to measure flows into the local distribution system.

(7) Local distribution systems will be of reduced voltage.

Order 888, ¶ 31,036 at 31,981.

The state petitioners argue that FERC's dual approach radically expands its jurisdiction and violates Congress' explicit directive in FPA § 201(b) that regulation of local distribution facilities be left to the states. The states contend that Congress clearly intended to preserve state jurisdiction over local distribution facilities, regardless of whether the energy comes from out of state or the sale is a wholesale sale. The states maintain that, by claiming jurisdiction over any facility transporting energy for resale, regardless of whether the facility might otherwise be a local distribution facility under the seven factor test, FERC has adopted the circular reasoning that wholesale sales do not occur on local distribution facilities, so any facility that engages in wholesale activities is not a local distribution facility. The states contend further that FERC offers no reasoned analysis of why local distribution should be defined differently for wholesale versus retail sales. The states finally charge that, under Order 888, nearly identical facilities would be under federal jurisdiction and state jurisdiction for different customers receiving indistinguishable service. Such a situation, they contend, will only encourage energy marketers to choose their regulator by using middlemen to shift the point at which title to the power transfers, and thus undermine the jurisdictional certainty that Order 888 states is necessary for competition.

FERC responds that it is not asserting jurisdiction over local distribution facilities, but asserts that when a public utility delivers unbundled energy at wholesale to a supplier for the purpose of resale to an end user, FPA § 201 gives FERC unqualified authority to assert jurisdiction over the facility used to effect that transaction. When the public utility is engaged in unbundled retail transmission, however, (34)the circumstances of a specific case will determine whether the facilities used are subject to FERC or state jurisdiction. The arguments by the states do no more than raise policy concerns which are for FERC and not the court. *See Arent v. Shalala*, 70 F.3d 610 (D.C. Cir. 1995).

Intervening again on FERC's behalf on this issue, the U&D petitioners add that FERC's use of different tests is appropriate given the differences in the two separate jurisdictional grants of FPA § 201. The interveners argue that, given the statute's clear grant to FERC of jurisdiction over all aspects of wholesale sales, FERC is fully justified in employing a functional test to identify wholesale transmissions. In contrast, because FERC's jurisdiction over retail sales is limited to transmissions in interstate commerce, the seven factor test is more appropriate.

We agree that FERC's dual approach to assessing its jurisdiction stems from the fact that FPA § 201 contains more than one jurisdictional grant. FPA § 201(b) denies FERC jurisdiction over local distribution facilities "*except as specifically provided in this subchapter and subchapter III.*" 16 U.S.C. § 824(b)(1) (emphasis added). FPA § 201(a) makes clear that all aspects of wholesale sales are subject to federal regulation, regardless of the facilities used. FERC's assertion of jurisdiction over all wholesale transmissions, regardless of the nature of the facility, is clearly within the scope of its statutory authority. Moreover, various cases support the proposition that FERC regulates all aspects of wholesale transactions. *See, e.g., Duke Power Co. v. FPC*, 401 F.2d 930. 935-36 (D.C. Cir. 1968) (noting that the FPC regulates public utility facilities used in wholesale transmissions or sales in interstate commerce); *Arkansas Power & Light Co. v. FPC*, 368 F.2d 376, 383 (8th Cir. 1966) (stating that the functional use of the transmission lines—wholesale versus retail—controls); *Wisconsin-Michigan Power Co. v. FPC*, 197 F.2d 472, 477 (7th Cir. 1952) (finding that transmission facilities used at wholesale are not "local distribution facilities").

(35)The seven factor test applies only to unbundled retail sales, where FERC seeks to regulate pursuant to the separate grant of jurisdictional authority over transmissions in interstate commerce. In this context, the definition of "facilities used in local distribution" becomes relevant. The statute does not define "facilities used in local distribution," but instead leaves that task to FERC. As *Chevron* counsels us, FERC's interpretation of undefined and ambiguous statutory terms is entitled to deference. *See Chevron*, 467 U.S. at 842-43.

FERC has adopted a multi-factor test to determine the nature of transmission facilities. In a footnote, Order 888 says that distribution-only facilities which sell only at retail will still be considered local distribution facilities. *See* Order 888, ¶ 31,036 at 31,981 n.99. This is consistent with the fact that states historically have regulated bundled retail sales to end users. However, Order 888 implicitly recognizes the current reality that many primarily retail utilities engage in both local distribution and interstate transmissions, and seeks through the seven factors to discern each facility's primary function. We cannot agree with the state petitioners that this approach is unreasonable or otherwise impermissible.

IV. RECIPROCITY

Section 6 of the Tariff contains a reciprocity provision resting on the principle that any public utility offering "non-discriminatory open access transmission for the benefit of customers should be able to obtain the same non-discriminatory access in return." Order 888, ¶ 31,036 at 31,760. Non-public utilities—those outside the Commission's jurisdiction because, for instance, they are state-owned, *see* 16 U.S.C. § 824(f)—would otherwise not have to offer open-access. Under the Tariff, a public utility does not have to offer them access unless they reciprocate. In order to avoid controversies between public and non-public utilities regarding reciprocal service, the

Commission adopted a voluntary "safe harbor" provision pursuant to which non-public utilities could submit a transmission tariff to the Commission for a (36)determination whether it satisfied the reciprocity condition. If it did, the public utility would have to offer service; if it did not, the public utility could refuse service (although it had the option of waiving the reciprocity condition, as did the Commission itself).

A. *Indirect Regulation of Non-Jurisdictional Utilities*

Nebraska Public Power District (NPPD), a state entity, provides electrical generation, transmission and distribution service to wholesale and retail customers throughout Nebraska.[7] It claims that the Commission, through the reciprocity provision, has reached beyond its statutory authority and is illegally attempting to regulate entities, including NPPD, over which the Commission has no jurisdiction, in violation of the Federal Power Act and the Tenth Amendment to the Constitution. NPPD admits that pursuant to Nebraska law, all state power districts are obligated to provide open access transmission service. They have been doing so for years. This is doubtless why, after Order No. 888 issued, another Nebraska public power district so easily obtained a safe harbor declaration. *See Omaha Pub. Power Dist.*, 81 F.E.R.C. ¶ 61,054 (1997). In light of this, the Commission argues—and we agree—that NPPD's petition is unripe. Since NPPD already offers open access transmission, it is far from certain that the reciprocity provision will have any effect on it.[8] It certainly has not demonstrated any particular hardship that it would suffer if we refused to engage in pre-enforcement judicial review. *See AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 386 (1999). From all that appears, no public utility has refused, or even threatened to refuse, to give NPPD access to its transmission system in the wake of (37)Order No. 888.[9] Given the fact that public utilities may waive the reciprocity provision anyway, and that NPPD has the same option of obtaining a safe harbor as did the Omaha Public Power District, we are not persuaded that the provision is currently altering NPPD's conduct of its affairs or that withholding judicial review will cause it any hardship whatever. "Unlike the drug manufacturers in *Abbott Laboratories [v. Gardner*, 387 U.S. 136 (1967)], but like the cosmetics companies in *Toilet Goods Ass'n v. Gardner*, 387 U.S." 158, 164 (1967), NPPD need not change its "behavior or risk costly sanctions." *Clean Air Implementation Project v. EPA*, 150 F.3d 1200, 1205 (D.C. Cir. 1998). Furthermore, exactly how the Commission will fill in the contours of the reciprocity provision remains to be seen. That it may defer to state commissions, as it indicated in *Houston Lighting & Power Co.*, 81 F.E.R.C. ¶ 61,015 (1997), *order on reh'g*, 83 F.E.R.C. ¶ 61,181 (1998), affects NPPD's contention that the Commission is seeking to bring about nationwide uniformity by forcing non-public utilities to comply with its "detailed mandates." NPPD Brief at 5. We therefore believe the issues raised would benefit from a more concrete setting in which NPPD can demonstrate exactly how the reciprocity provision has affected its primary conduct. *See Clean Air Implementation Project*, 150 F.3d at 1204. For all these reasons, NPPD's challenge to the reciprocity provision is not ripe for judicial review.

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[7] "Nebraska is unique among the States in the Union in that *all* generation, transmission and distribution service is provided by public entities, municipalities and cooperatives whose governing boards are responsible to, and serve at the voting pleasure of, the rate-payers they serve." NPPD Brief at 2.

[8] The Commission made clear that existing contracts will not be affected. *See* Order 888-A, ¶ 31,048 at 30,181.

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[9] For this reason we find unpersuasive NPPD's claim that the Tariff's reciprocity provision places it at a disadvantage in negotiations because a public utility may simply refuse to provide service without any fear of a Commission enforcement action. *See* NPPD Reply Brief at 4-5.

B. *Limitation on Reciprocity*

The Investor Owned Utilities (IOUs) challenge the following limitation on reciprocity: non-public utilities owe reciprocal open access only to the public utility from which they take open access service—not to all utilities. *See* IOU Brief at 40-44; IOU Reply Brief at 18-20. These petitioners argue that the Commission has left open the door for non-public utilities (38)to discriminate against all other utilities and that it has done so solely because of tax considerations that no longer apply.

We agree with Commission counsel that tax considerations were not the only basis on which the Commission's limitation rested. The Commission stated that "the reciprocity requirement strikes an appropriate balance by limiting its application to circumstances in which the non-public utility seeks to take advantage of open access on a public utility's system." Order 888, ¶ 31,036 at 31,762. The Commission also explained that it "do[es] not have the authority to require non-public utilities to make their systems generally available." *Id.* at 31,761. The Commission stated also that it did not want broad open access reciprocity to jeopardize the tax-exempt financing non-public utilities enjoy,[10] that the IRS was then reexamining the question, *id.* at 31,762, and that if the tax issue is favorably resolved, it will reconsider the matter. Order 888-A, ¶ 31,048 at 30.287. The IRS has now acted. *See* Temporary Regulations § 1.141-7T(f), *in* 63 Fed. Reg. 3256 (1998). The IOUs argue that we must therefore remand for reconsideration. *See* IOU Brief at 44 (citing *Panhandle Eastern Pipeline v. FERC*, 890 F.2d 435, 439 (D.C. Cir. 1989); *National Fuel Gas Supply Corp. v. FERC*, 899 F.2d 1244, 1249-50 (D.C. Cir. 1990); *Ciba-Geigy v. EPA*, 46 F.3d 1208 (D.C. Cir. 1995)).

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[10] *See* 26 U.S.C. §§ 141, 142 (permitting "private activity" bonds and "local furnishing" bonds, respectively).

We think not. So far as we know, the IRS has not finalized its temporary and proposed regulations. The IRS acknowledges that its temporary regulations "raised[ ] a number of complex technical issues" many of which "may need to be addressed legislatively" and it anticipates that the finalization process will take three years to accomplish. 63 Fed. Reg. at 3258-59. Second, as the Commission indicates, the possible tax consequences of requiring open access from non-jurisdictional utilities was its secondary concern. The Commission's greater concern was its lack of jurisdiction to do what the IOUs ask. And lastly the Commission should be (39)taken at its word that it will reconsider the scope of reciprocity when and if the temporary tax regulations are finalized.

V. STRANDED COST RECOVERY PROVISIONS

Ordering open access transmission, Order 888-A explains that "[t]he most critical transition issue that arises as a result of the Commission's actions in this rulemaking is how to deal with the uneconomic sunk costs that utilities prudently incurred under an industry regime that rested on a regulatory framework and a set of expectations that are being fundamentally altered." Order 888-A, ¶ 31,048 at 30,346. "If a former wholesale requirements customer or a former retail customer uses the new open access to reach a new supplier," FERC said, "we believe that the utility is entitled to recover legitimate, prudent and verifiable costs that it incurred under the prior regulatory regime...." Order 888, ¶ 31,036 at 31,789.

According to FERC, these "stranded" costs consist predominantly of costs of building generation capacity, which utilities incurred with the expectation that they would use the additional capacity to serve existing customers. *See* Notice of Proposed Rulemaking, *Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, FERC Stats. & Regs. ¶ 32,507 at 32,863-64, 59 Fed. Reg. 35,274 (1994) ("Stranded Cost NOPR"). Because of the increased competition in the generation market that will result from open access, this capacity may become underutilized or uneconomical, *i.e.*, "stranded." Stranded costs also include nonrecurring costs approved by regulators that, in order to avoid rate increases, were recovered over a period of years instead of at the time the expenditures were made. Known as "regulatory assets," these costs include deferred income taxes, deferred pension and other employee benefit and retirement costs, research and development, extraordinary property losses, and the phase-in of new plant costs. Nuclear decommissioning costs and costs to buy out high-priced fuel and power contracts may also become stranded as a result of open access.

(40)Exercising its exclusive jurisdiction over wholesale power sales, FERC through Order 888 gave utilities the opportunity to recover their stranded costs from former wholesale customers who take advantage of open access transmission to purchase power from other suppliers. Order 888, ¶ 31,036 at 31,810. With respect to stranded costs resulting from state-ordered retail wheeling, Order 888 provides that FERC will consider stranded cost claims only when state regulatory agencies lack authority to do so. *Id.* at 31,824-25. Order 888 also designated FERC as the primary forum for stranded cost claims stemming from what are known as new municipalizations and municipal annexations. *See* Order 888-A, ¶ 31,048 at 30,404; Order 888-B, 81 FERC at 62,104. Stranded costs in these situations result from retail (as opposed to wholesale) power sales.

Petitioners challenge nearly every aspect of FERC's stranded cost policy as set forth in Order 888, from the mechanics of calculating customers' stranded cost obligations to whether FERC has authority to address stranded costs at all. We begin with those challenges that relate to the recovery of wholesale stranded costs (Section V.A), then turn to challenges to Order

888's treatment of retail stranded costs (Section V.B). We affirm FERC's stranded cost policy in all respects, except we vacate that portion of the orders dealing with the treatment of energy costs in the market option and remand to FERC for further explanation. *See* Section V.A.5.c.

A. *Wholesale Stranded Costs*

In requiring nondiscriminatory open access transmission as a remedy for undue discrimination, FERC recognized that it "cannot change the rules of the game without providing a mechanism for recovery of the costs caused by such regulatory-mandated change." Order 888-A, ¶ 31,048 at 30,346. Under the pre-open access regulatory regime, utilities entered into long-term contracts to make wholesale power sales to municipal, cooperative, and investor-owned utilities. *See* Stranded Cost NOPR, ¶ 32,507 at 32,862. Because these customers had no source of power supply other than (41)their historic utility, these contracts were typically extended at the end of their term. This produced an implicit obligation by the utilities to continue satisfying their customers' power needs, as well as a reciprocal expectation by customers of continued service. *See id.* at 32,863-64. To satisfy expected customer demand, utilities invested money, built facilities, and entered into long-term fuel or power contracts, relying on the "regulatory compact" under which utility shareholders accepted lower rates of return on their investment in exchange for the certainty of regulated rates and resulting ability to recover prudently incurred costs. *See* Notice of Proposed Rulemaking, *Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, FERC Stats. & Regs. ¶ 32,514 at 33,049, 60 Fed. Reg. 17,662 (1995).

Order 888 fundamentally undermines utilities' expectation of continued service and cost recovery. A utility's requirements

customers may now use the utility's open access transmission service to purchase power from other suppliers at the end of their contract terms. If customers leave before paying their share of costs the historic utility incurred on their behalf, the utility will be left with stranded costs, which it will either absorb or shift to remaining customers.

Unless utilities are able to recover stranded costs, FERC reasoned, their ability to compete and attract investor capital in a deregulated market may be seriously impaired. FERC therefore decided that it had to "address recovery of the transition costs of moving from a monopoly-regulated regime to one in which all sellers can compete on a fair basis and in which electricity is more competitively priced." Order 888, ¶ 31,036 at 31,635. In reaching this conclusion, FERC relied on its experience in restructuring the natural gas industry, where this court faulted it for failing to provide transitional mechanisms such as stranded cost recover. FERC explained: "We have learned from our experience in the natural gas area the importance of addressing competitive transition issues early and with as much certainty to market participants as possible." *Id.*

(42)In shaping its stranded cost recovery mechanism, FERC had to balance two competing interests: speeding the transition to competition versus protecting utilities that had incurred costs with the expectation that their customers would remain and eventually pay those costs through electricity rates. Allowing recovery of stranded costs, FERC acknowledged, would delay full realization of the benefits of open access—lower electricity rates—because customers facing stranded cost liability might continue purchasing power from their historic utility even though competitors are selling power at lower rates. *See* Order 888-A, ¶ 31,048 at 30,355. Indeed, a customer would only switch suppliers if the competitor offered a rate less than the historic utility's rate plus the customer's stranded cost liability. But given the highly regulated nature of the electricity industry, in which utilities incurred costs with the expectation of recouping them, FERC concluded that the delay was a necessary component of its open access program. *See id.* Mindful of its ultimate goal of converting the electricity industry into a competitive market, however, FERC fashioned the stranded cost recovery provisions to be transitional, allowing utilities to recover stranded costs only in connection with wholesale requirements contracts entered into on or before July 11, 1994 (the date of the stranded cost notice of proposed rulemaking). *See* 18 C.F.R. § 35.26(b)(8), 35.26(c)(1)(v)-(vi).

As to precisely who should pay for stranded costs, utilities and customers not surprisingly had dramatically different positions. Customers argued that utilities should absorb most, if not all, stranded costs. Utilities (and their investors) argued that customers should pay.

Facing an enormously difficult task in balancing these sharply conflicting positions, FERC crafted a rule that requires customers to pay stranded costs but only in certain circumstances. Most important, in order to recover stranded costs from a customer, the historic utility must prove that it had a reasonable expectation of continued service to that particular customer for a certain number of years beyond the end of the contract term; a utility unable to prove such an expectation may not recover stranded costs under Order 888. (43)*See* 18 C.F.R. § 35.26(c)(2)(i). Moreover, a utility able to demonstrate a reasonable expectation of continued service may recover stranded costs only if its wholesale customer actually takes advantage of the utility's open access tariff to obtain access to a new generation supplier at the end of its contract term (*i.e.*, the former customer continues to use the historic utility's transmission service but no longer purchases power from it). *See* 18 C.F.R. § 35,26(b)(1)(i). Through these two limitations, FERC balanced the interests of utilities and customers by allowing utilities to recover their stranded costs only if they can demonstrate a reasonable expectation of continued service and requiring customers to pay those costs only if they take advantage of their historic utility's open access transmission to reach cheaper sources of power. And of course, no customer will have to pay stranded costs at all if it continues purchasing power from its historic utility throughout the period during which the utility has a reasonable expectation of continued service —precisely what the customer would have done in the absence of Order 888's open access requirement.

Under Order 888, stranded costs are calculated on a "revenues lost" basis. A departing customer's stranded cost obligation equals the estimated revenue it would have paid had it continued to purchase power from the historic utility minus the current market value of the power it would have purchased, calculated over the period the utility is determined to have a reasonable expectation of continued service to that customer. *See* 18 C.F.R. § 35.26(c)(2)(iii). In other words, the stranded cost formula is not tied to particular stranded assets or contractual commitments, but rather awards utilities the difference between the pre-open access cost-based rate and the post-open access market rate. Once a customer's stranded cost liability is calculated, it may pay through a lump-sum payment, installment payments, or a surcharge to the transmission rate charged by the historic utility. *See* Order 888, ¶ 31,036 at 31,799.

Before turning to petitioners' arguments, we emphasize what should be obvious from the foregoing summary of Order 888: Order 888 awards stranded costs to no one. It does (44)nothing more than establish a mechanism by which utilities may seek to recover stranded costs. To recover stranded costs, a utility must demonstrate its continued expectation of service at an evidentiary hearing. The customer may appear at that hearing and, through evidentiary submissions of its own, attempt to demonstrate that the utility had no such expectation. Only after such a hearing may FERC decide whether a utility can recover stranded costs and, if so, how much.

Petitioners mount many challenges to Order 888's stranded cost recovery provisions. For purposes of analysis, we group these challenges into five categories: (1) challenges to FERC's authority to provide for stranded cost recovery (section V.A.1); (2) claims that Order 888 conflicts with cost causation principles and case law developed under the Natural Gas Act (section V.A.2); (3) challenges to FERC's *Mobile-Sierra* findings (section V.A.3); (4) claims that FERC arbitrarily and capriciously failed to provide for stranded cost recovery by certain entities, such as transmission dependent utilities and generation and transmission cooperatives (section V.A.4); and (5) challenges to various technical aspects of Order 888's stranded cost recovery provisions (section V.A.5).

1. *FERC's Authority to Provide for Stranded Cost Recovery*

A group called Petitioners Opposing Stranded Cost Recovery ("POSCR") advances three challenges to FERC's authority to provide for stranded cost recovery: (1) as a factual matter, utilities could nver have had a reasonable expectation of continued service to wholesale customers beyond the contract term; (2) sections 206 and 212 of the Federal Power Act ("FPA") forbid stranded cost recovery; and (3) our decision in *Cajun Elec. Power Coop., Inc. v. FERC*, 28 F.3d 173 (D.C. Cir. 1994), holds that stranded cost recovery is anticompetitive. We consider each argument in turn.

a. *Reasonable expectation of continued service*

To recover stranded costs relating to a specific departing wholesale requirements customer, a utility must show that it (45)had a reasonable expectation of service to that customer beyond the term of its existing contract. *See* 18 C.F.R. § 35.26(c)(2)(i). Pointing out that contracts define the extent of the parties' obligations and that customers have long exercised their rights to purchase power from other suppliers at the end of their contract terms, POSCR contends that utilities could never have had an expectation of service beyond their contract terms. In considering this argument it is important to remember that Order 888 does not itself award stranded costs; it merely establishes a procedure by which utilities may petition FERC in individual proceedings to recover stranded costs from a specific customer based on a specific evidentiary showing. Utilities failing to show an expectation of continued service will be unable to recover stranded costs. POSCR's challenge thus amounts to a claim that no utility could ever, under any circumstances, have had a reasonable expectation to serve a wholesale customer beyond the term of its contract. We review this claim under the APA's familiar arbitrary and capricious standard. *See* 5 U.S.C. § 706(2)(A); *Williams Field Services Group, Inc. v. FERC*, 194 F.3d 110, 115 (D.C. Cir. 1999).

Responding to this same challenge in Order 888-A, FERC explained that utilities historically had an implicit obligation to serve customers beyond the contract term for a simple reason: Customers had no means of reaching alternative suppliers. *See* Order 888-A, ¶ 31,048 at 30,354. As part of that obligation to serve, FERC found, a local utility "had a concomitant obligation to plan to supply [its] customers' continuing needs, and planned its system taking account of the wholesale load. In many cases the wholesale customers participated by supplying load forecasts." *Id.* In making capital decisions and predicting future demand, utilities frequently consulted with their wholesale requirements customers. For these reasons, FERC concluded, utilities may have a reasonable expectation of continued service to particular customers. *See id.* at 30,354-55.

Not only is FERC's judgment about utilities' reasonable expectations precisely the type of policy assessment to which we owe great deference, but POSCR points to nothing sug-(46)gesting that FERC's reasoning is arbitrary and capricious. In fact, POSCR's argument completely ignores the highly regulated nature of the electricity industry prior to Order 888. Unlike competitive markets, where buyers may freely purchase from many sellers, the monopolistic character of the electricity industry, combined with the congressionally imposed regulatory structure, left requirements customers highly dependent on a single supplier—their historic utility. Indeed, as interveners point out, utilities were even unable to choose not to renew an expiring wholesale requirements contract without first notifying FERC. *See* 18 C.F.R. § 35.15 (1995) (repealed by Order 888). Although it may well be true, as POSCR argues, that some wholesale customers have long been able to purchase unbundled transmission service, we think such evidence is best reserved for individual proceedings, where a department customer can attempt to refute the utility's claim that it had an expectation of continued service.

b. *Sections 206 and 212 of the FPA*

Section 206(a) of the FPA gives FERC authority to "determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force" if it finds that any existing arrangement "is unjust, unreasonable, unduly discriminatory or preferential." 16 U.S.C. § 824e(a). Relying on section 206(a) as the basis for Order 888, FERC found that utilities had used their monopoly transmission power to discriminate against potential competitors and that such practices would increase as competitive pressures in the industry increased. Order 888, ¶ 31,036 at 31,676, 31,682.

POSCR contends that Order 888's stranded cost recovery provisions themselves violate FERC's own construction of section 206, the construction FERC relied on as the basis for the open access rule. According to POSCR, "[t]he stranded cost rule perpetuates the very 'discrimination' FERC found unlawful, and subjects the same victims—customers held hostage to uneconomic electric generation by transmission monopolists—to continued abuse."

(47)In challenging FERC's policy decision to provide for stranded cost recovery, POSCR conflates the violation (FERC's generic determination that utilities' practice of prohibiting access to their transmission lines on reasonable terms was unduly discriminatory) with the remedy (FERC's more limited finding that recovery of stranded costs in particular circumstances would not be unduly discriminatory). FERC has not, as POSCR contends, given "unduly discriminatory" different meanings; rather, it has applied the term in different contexts.

POSCR's argument thus boils down to a challenge to FERC's conclusion that the stranded cost recovery prescribed in Order 888 is not unduly discriminatory, a challenge meriting arbitrary and capricious review. Viewed through this lens, we think FERC more than adequately explained why it concluded that stranded cost recovery is not unduly discriminatory—stranded cost recovery, FERC said, is transitional only, follows cost causation principles, and requires utilities to prove that they had a reasonable expectation of continued service. FERC faced an enormously difficult task. It had to balance the transition to competitive markets against the need to maintain the competitiveness of utilities that had incurred costs based on a reasonable expectation that they would recoup them. We find nothing either arbitrary or capricious in how FERC struck this balance.

POSCR next contends that stranded cost recovery violates section 212 of the FPA, which governs the rates for transmission ordered by FERC pursuant to section 211. 16 U.S.C. §§ 824j-k. Because FERC-jurisdictional utilities are no longer subject to sections 211 and 212, this argument relates only to those situations in which FERC orders nonjurisdictional transmitting utilities to wheel under section 211 and these utilities then seek to recover stranded costs in their transmission rates. *See* 18 C.F.R. § 35.26(c)(1)(vi)-(vii). Section 212 allows FERC to order "rates, charges, terms, and conditions which permit the recovery by [a transmitting] utility of all the costs incurred in connection with the transmission services and necessary associated services, including, but not limited to, an appropriate share, if any, of legitimate, verifiable and (48)economic costs, including taking into account any benefits to the transmission system of providing the transmission service, and the costs of any enlargement of transmission facilities." 16 U.S.C. § 824k(a). Contending that "economic costs" cannot be read to include payment of stranded costs, which by definition relate to generation (not transmission) services, POSCR reads section 212 to preclude stranded cost recovery.

Straightforward application of the *Chevron* doctrine demonstrates the lack of merit in this argument. *See Chevron, U.S.A., Inc. v. Natural Resources Defense Council*, 467 U.S. 837 (1984). Because Congress has not "directly spoken to the precise question at issue"—do "economic costs" include stranded costs?—and because nothing in the statute precludes recovering through transmission rates costs that were traditionally recovered through generation rates, the term "economic costs" is ambiguous. *Id.* at 842.

Proceeding to *Chevron*'s second step, we ask whether FERC has reasonably interpreted the term "economic costs." *See id.* at 843. We have no doubt that it has. As FERC explained, but for section 211 wheeling orders, there would be no stranded costs. Stranded costs, according to FERC, are therefore economic costs of section 211 wheeling. *See* Order 888-A, ¶ 31,048 at 30,390. POSCR offers nothing to undermine this eminently reasonable interpretation of the statute.

c. *Implications of* Cajun

Next, POSCR contends that our decision in *Cajun Elec. Power Coop., Inc. v. FERC*, 28 F.3d 173 (D.C. Cir. 1994), condemns stranded cost recovery as anticompetitive. A pre-Order 888 decision, *Cajun* reviewed two tariffs allowing a utility, Entergy Corporation, to sell power at market rates, and a third tariff providing for open access to Entergy's transmission services at cost-based rates. The third tariff gave Entergy an opportunity to recover stranded costs from customers who no longer purchase power from Entergy but use its transmission lines to reach other suppliers—exactly the circumstances in which Order 888 provides for stranded cost recovery. Under the tariff, the stranded cost charge was included in Entergy's transmission rate. *See id.* at 175-77.

(49)Characterizing the stranded cost provision as a "tying arrangement" under antitrust law, *Cajun* explained that under the tariff, Entergy could charge a former customer for the cost of generation services when the customer wished to purchase only transmission services; because Entergy has a monopoly over transmission, customers would have no choice but to pay costs relating to generation they no longer wanted from Entergy. *Id.* at 177-78. Thus, because "Entergy could use its monopoly over transmission services to eliminate competition in the market for generation services," the net effect of the tariffs may be anticompetitive. *Id.* at 176.

Of significance to this case, however, we did not strike down the tariffs. Instead, we remanded the case for FERC to determine "how much competition in fact is dampened" by the stranded cost provision. *Id.* at 178. Thus, contrary to POSCR's suggestion, *Cajun* does not represent a blanket condemnation of stranded cost recovery; rather, recognizing that such recovery could be anticompetitive, *Cajun* directed FERC to evaluate and justify the potential anticompetitive impact. This is precisely what FERC has done in Order 888. It expressly considered the anticompetitive effects of stranded cost recovery. *See* Order 888-A, ¶ 31,048 at 30,372-74. Then, stressing the transitional nature of the recovery and the fact that recovery was compelled by the open access requirement, which utilities could not have anticipated, FERC concluded that the limited anticompetitive effects of stranded cost recovery were both a necessary and acceptable consequence of the transition to competition. *See id.* Not only has POSCR offered no evidence that would lead us to question FERC's conclusion, but such judgments about anticompetitive effects are "the kind of reasonable agency prediction about the future impact of its own regulatory policies to which we ordinarily defer." *Louisiana Energy and Power Auth. v. FERC*, 141 F.3d 364, 370 (D.C. Cir. 1998).

2. *Natural Gas Precedent and Conformance to Cost Causation Principles*

Having rejected POSCR's arguments that FERC lacks authority to authorize stranded cost recovery, we turn to its (50)argument that FERC has failed adequately to explain why Order 888 requires departing customers to pay one-hundred percent of stranded costs. In support of this argument, POSCR claims that our decisions reviewing FERC's restructuring of the natural gas industry require cost sharing; it also argues that Order 888's stranded cost recovery conflicts with the cost causation principles that traditionally govern allocation of costs.

a. *Natural gas precedent:* AGD, K N Energy, *and* UDC

In introducing competition into the electricity industry, FERC has taken essentially the same path that it took in restructuring the natural gas industry, although what FERC has done in a single order in the electricity industry (Order 888) it did in a series of orders in the natural gas industry. Because POSCR relies so heavily on FERC's natural gas orders and our decisions reviewing them, we begin by summarizing them in some detail.

Finding practices in the natural gas industry "unduly discriminatory" in violation of the Natural Gas Act, FERC began by issuing Order 436, which "unbundled" pipeline transportation and merchant functions. *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol,* Order No. 436, FERC Stats. & Regs. ¶ 30,665, 50 Fed. Reg. 42,408 (1985) (rehearing orders omitted). At the time of Order 436, pipelines were facing enormous liabilities under long-term "take-or-pay" contracts. Entered into when gas prices were expected to rise, these contracts obligated pipelines to purchase minimum quantities of gas from wellhead producers at fixed prices that turned out to be well in excess of market prices. *See Associated Gas Distributors v. FERC*, 824 F.2d 981, 1021 (D.C. Cir. 1987) ("*AGD*"). Although FERC estimated take-or-pay liabilities at billions of dollars, and although Order 436 would exacerbate the take-or-pay problem by providing incentives to pipeline customers to purchase gas from cheaper suppliers, FERC declined to take any action with respect to the contracts. In *AGD*, we found that FERC's decision to do nothing failed to meet the requirements of reasoned decisionmaking, citing FERC's "seeming (51)blindness to the possible impact of Order No.436 on take-or-pay liability" and permanent market distortions that may result from FERC's inaction. *Id.* at 1021-23, 1025. Specifically, we noted, in words echoed by FERC years later in Order 888, that consumers who purchased from the "least nimble" local distribution companies would "be stuck with the burden of the overpriced gas." *Id.* at 1023.

In response to *AGD*, FERC issued Order 500. *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, Order No. 500, FERC Stats. & Regs. ¶ 30,761, 52 Fed. Reg. 30,334 (1987) (rehearing orders omitted). Recognizing that no one segment of the gas industry was wholly responsible for the take-

or-pay problem, Order 500 allowed pipelines to recover take-or-pay costs through "equitable sharing." Pipelines that willingly absorbed twenty-five to fifty percent of their costs could require sales customers to match that amount through a fixed charge. Pipelines could recover any balance through commodity rates or volumetric surcharges, borne by both sales and transportation customers. For an overview of these components of Order 500, see *K N Energy, Inc. v. FERC*, 968 F.2d 1295, 1297-98 (D.C. Cir. 1992). We sustained this approach in *K N Energy*, holding that even though Order 500 replaced traditional "cost causation" principles with cost spreading and value-of-service concepts, it did not violate Natural Gas Act section 4's requirement that rates be just and reasonable. *Id.* at 1301-02. Citing statements in *AGD* that "all actors in the natural gas industry" are "candidates" for absorbing take-or-pay liability, we relied on "the unusual circumstances surrounding the take-or-pay problem, and the limited nature—both in time and scope—of the Commission's departure from the cost-causation principle." *Id.* at 1301.

Concluding that Order 436 had been only partially successful in introducing competition into the natural gas industry, FERC issued its third major restructuring order, Order 636. *Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation; and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, Order No. 636, FERC Stats. & Regs. ¶ 30,939, 57 Fed. (52) Reg. 13,267 (1992) (rehearing orders omitted). That order imposed mandatory unbundling of sales and transportation services and allowed sales customers to reduce the amount of gas they had to purchase pursuant to existing contracts. When customers took advantage of this option and purchased gas from sources other than the pipelines, the pipelines were once again left with substantial take-or-pay liabilities. Labeling the costs of reducing these liabilities gas supply realignment or GSR costs, Order 636 authorized pipelines to bill current transportation customers for one-hundred percent of their GSR costs by charging either a

negotiated exit fee or reservation fee surcharge. Order 636 also authorized pipelines to recover all stranded costs in rate filings. In the natural gas industry, stranded costs represented the costs of pipeline assets (such as storage facilities) used to provide bundled sales services that were not directly assignable to transportation customers. For an overview of these components of Order 636, see *United Distribution Cos. v. FERC*, 88 F.3d 1105, 1125-27, 1176-78 (D.C. Cir. 1996) ("*UDC*").

In *UDC*, we affirmed FERC's determination that pipelines could recover all stranded costs through filed rates, so long as FERC "adequately balanced the interests of investors and ratepayers." *Id.* at 1180. Reaffirming the appropriateness of the cost spreading and value-of-service principles approved in *K N Energy*, we found that FERC's allocation of GSR costs to pipeline transportation customers, as opposed to the pipelines themselves, properly applied those principles. *Id.* at 1182. Although recognizing that GSR costs stemmed from pipeline sales customers, not transportation customers, we found that FERC appropriately imposed the costs on transportation customers because these customers benefitted from the availability of lower-priced transportation and also because FERC could not spread costs to the pre-Order 636 sales customers since those customers no longer purchased gas from the pipelines. *Id.* at 1185-86. We remanded for FERC to explain more fully why pipelines should not have to pay some of the costs, noting an inconsistency in the Commission's analysis: While FERC applied *cost spreading* principles to justify imposing costs on transportation customers, it (53)invoked *cost causation* principles in concluding that pipelines should not have to pay any of these costs. *Id.* at 1188-90. We explicitly stated, however, that we were not saying that "it is impossible, or even improbable, that the Commission on remand can establish a convincing rationale for exempting the pipelines." *Id.* at 1189.

POSCR reads this history to require FERC to order cost sharing, but it ignores Order 888's explanation of the difference between natural gas restructuring and the situation in the electricity industry. Most fundamentally, Order 888 explains, stranded cost recovery in the electricity industry conforms to cost causation principles, which normally govern the allocation of costs and require customers to pay the costs they caused. *See* Order 888, ¶ 31,036 at 31,798. Cost causation principles could not be applied in natural gas restructuring, Order 888 explains, because many customers had already begun purchasing gas from other suppliers before FERC had addressed the take-or-pay problem on remand from *AGD*, and because the filed rate doctrine prohibits assessing charges against former customers. *Id.* at 31,800-01. Order 888 also explains that unlike stranded costs in the electricity industry, the take-or-pay liabilities in the gas industry were extraordinary. The billions of dollars of take-or-pay liabilities resulted not from Order 636, but from earlier regulatory policies that had encouraged pipelines to enter into long-term, fixed-price gas purchase contracts, combined with declining gas prices that made those contracts uneconomical. *See* Order 888-A, ¶ 31,048 at 30,380. Under all of these circumstances, "[t]o have allocated these costs solely to any one segment of the industry would have imposed a crushing new burden on that segment." *Id.* at 30,380-81.

Stranded costs in the electricity industry, Order 888 explains, are quite different. Resulting directly from Order 888, they represent "ordinary costs that have always been, and are currently, included in the utility's rates for electric generation approved by the Commission." *Id.* at 30,382. Moreover, wholesale customers may avoid stranded cost liability by continuing to purchase power from their historic utility, precisely what they probably would have done in the (54)absence of Order 888. In other words, in contrast to the natural gas industry, where customers would have faced enormous new burdens had FERC forced them to pay take-or-pay costs, customers in the electricity industry face no new burdens; instead, Order 888 requires them to pay nothing more than costs they would have had to pay in the absence of Order 888. In the electricity industry, the only effect of stranded cost recovery is delayed realization of the full benefits of a competitive market.

In light of these differences between the natural gas and electricity industries and FERC's exhaustive treatment of the natural gas restructuring in Order 888, POSCR's contention that FERC has failed "to offer a coherent rationale, rising to the level of reasoned decisionmaking" for not imposing cost sharing is wholly without merit. Equally without merit is POSCR's assertion that *UDC* "teaches that, were customers and utilities benefit from an open access rule/order that leads to early contract termination and where anticompetitive conduct by utilities has given rise to the need for the open access order, utilities must share transition costs." POSCR ignores three important points. First, FERC, not this court, determined that cost sharing was appropriate with respect to take-or-pay liabilities. *UDC* merely affirmed FERC's decision. Second, *K N Energy* recognized that cost sharing in the natural gas industry was a departure from the cost causation principles that normally apply, a departure justified by extraordinary circumstances in the natural gas industry. *K N Energy*, 968 F.2d at 1301-02. And finally, as to stranded costs that more closely resemble those at issue in this case—for example, pipeline assets that would no longer be fully employed when customers took advantage of unbundling to purchase gas from alternative suppliers—FERC ordered, and *UDC* affirmed, that pipelines recover one-hundred percent of those costs.

b. *Conformance to cost causation principles*

Having established that the natural gas cases impose no obligation on FERC to order cost sharing, we next consider POSCR's argument that the inclusion of stranded costs in

(55)transmission rates does not conform to cost causation principles. This is so, POSCR asserts, because Order 888's stranded cost provisions require customers to pay through transmission rates for costs the utility previously incurred to provide generation services.

As an initial matter, we note that payment through transmission rates is only one of three ways that a departing customer may pay its stranded cost obligation; the customer also has the option of making a lump-sum payment or installment payments. Thus POSCR's challenge seems aimed only at the method of payment, not at the fact that payment is required. But even viewing POSCR's challenge more broadly, as a claim that stranded cost recovery no matter what the method of payment violates cost causation principles, we think it lacks merit.

We have explained the cost causation principle as follows: "Simply put, it has been traditionally required that all approved rates reflect to some degree the costs actually caused by the customer who must pay them." *K N Energy*, 968 F.2d at 1300. Given this definition, we are puzzled by POSCR's claim that because inclusion of stranded costs in transmission rates requires customers to pay currently for costs incurred in the past, it violates cost causation principles. To some degree, all utility rates reflect past costs; utilities typically expend funds today (for example, constructing generation facilities), fully expecting to recover those costs through future rates. In fact, current rates often include past costs that utilities deferred in order to avoid rate increases. Cost causation requires not that costs be incurred at the same time they are included in rates, but that the rates "reflect to some degree the costs actually caused by the customer who must pay them." *Id.*

In fashioning Order 888's stranded cost recovery provisions, FERC went to great lengths to ensure that customers would be responsible for only those costs they caused.

> [T]he Rule is consistent with the traditional cost causation principle because it recognizes the link between the incurrence of the stranded costs and the decision of a (56)particular generation customer to use open-access transmission on the utility's system to leave the utility's generation system and shop for power, and bases the utility's ability to recover stranded costs on its ability to demonstrate that it incurred costs with the reasonable expectation that the customer would remain on its generation system beyond the term of the contract.

Order 888-A, ¶ 31,048 at 30,382.

We cannot see how including stranded costs in transmission rates instead of lump sum payments changes this analysis. To the extent POSCR is arguing that including in a transmission rate costs incurred to provide generation services violates cost causation principles, we reiterate that stranded costs are not costs of providing the physical transmission services but, as Order 888-A explains, they are utilities' cost of open access transmission. *See* Order 888-A, ¶ 31,048 at 30,389 & n.634. More generally, given the fundamental changes wrought by Order 888 and the unprecedented opportunity for customers to purchase power from alternative suppliers, we are quite comfortable deferring to FERC's judgment that stranded cost recovery—through transmission rates or otherwise—conforms to cost causation principles. In fact, FERC may have violated cost causation principles had it failed to assign stranded costs to customers who caused them.

POSCR next argues that Order 888 is unduly discriminatory because including stranded costs in transmission rates forces transmission customers who previously used a utility's generation capacity to pay higher costs than new transmission customers.

Disagreeing, FERC determined that requiring customers receiving similar services to pay different rates is necessitated by Order 888's open access requirement. *See* Order 888-A, ¶ 31,048 at 30,388-90. *Cf. AGD*, 824 F.2d at 1009 ("[T]he mere fact of a rate disparity is not enough to constitute unlawful discrimination.") (internal quotation marks omitted). Moreover, FERC concluded, the application of cost causation principles justifies this different treatment. *See* Order 888-A, ¶ 31,048 at 30,379, 30-388-90. Seeing noth-(57)ing unreasonable (let alone arbitrary or capricious) in FERC's policy judgment, we reject POSCR's challenge.

Nor do we agree with POSCR's argument that stranded cost recovery violates the filed rate doctrine, which "forbids a regulated entity to charge rates for its services other than those properly filed with the appropriate federal regulatory authority." *Western Resources, Inc. v. FERC*, 72 F.3d 147, 149 (D.C. Cir. 1995). In *Western Resources*, we held that FERC's assignment to current customers of costs relating to take-or-pay liabilities did not violate the filed rate doctrine. Recognizing that "a central purpose of the doctrine is to enable purchasers to know in advance the consequences of the purchasing decisions they make," we determined that the doctrine was satisfied where customers received "adequate notice of a rate in advance of the service to which it relates." *Id.* at 149-50 (internal quotation marks omitted). Order 888's stranded cost policy satisfies this requirement because customers electing to purchase power generation from a source other than the transmitting utility from which they had purchased power in the past will be aware of the costs when making that decision.

3. *FERC's* Mobile-Sierra *Findings*

Under the Supreme Court's *Mobile-Sierra* doctrine, where parties have negotiated a contract that sets firm prices or dictates a specific method of computing charges and includes a clause denying either party the right to change such prices or charges unilaterally, "FERC may abrogate or modify the contract only if the public interest so requires." *Texaco, Inc. v. FERC*, 148 F.3d 1091, 1095 (D.C. Cir. 1998); *see also FPC v. Sierra Pacific Power Co.*, 350 U.S. 348, 353-55 (1956); *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332, 344-45 (1956). We have recognized that "the 'public interest' that permits FERC to modify private contracts is different from and more exacting than the 'public interest' that FERC seeks to serve when it promulgates its rules." *Texaco*, 148 F.3d at 1097.

FERC usually makes *Mobile-Sierra* determinations on a case-by-case basis. A party seeking to modify a contract (58)containing a *Mobile-Sierra* clause petitions FERC. That party bears the burden of convincing FERC that the modification is in the public interest.

Order 888 departs from this normal case-by-case practice by making two generic public interest findings, one focused on utilities, the other on customers. These generic findings relieve utilities and customers of the burden of demonstrating in individual proceedings that the proposed modifications are in the public interest. As to utilities, Order 888 ruled that it was in the public interest to allow them to add stranded cost amendments to their contracts if they could demonstrate, in accordance with Order 888, that they had a reasonable expectation of continued service. *See* Order 888-A, ¶ 31,048 at 30,394-95. This finding rested on two considerations: that the burden of unrecoverable stranded costs could impair utilities' access to capital markets, which could in turn precipitate the departure of other customers, thus worsening the utilities' financial condition and threatening its ability to provide reliable service; and that allowing customers to leave a utility without paying their share of costs would shift those costs to other customers who lack alternative power sources. *See* Order 888, ¶ 31,036 at 31,811. For its second generic finding, FERC concluded that it was in the public interest to allow customers to modify their wholesale requirements contracts in any way upon a showing that the terms are no longer just and reasonable. *See* Order 888-A, ¶ 31,048 at 30,189. Observing that the contracts in question "were entered into during an era in which transmission providers exercised monopoly control over access to their transmission facilities," FERC based this finding on the unequal bargaining power between utilities and customers. *Id.* at 30,193. Because "[m]any of these contracts were the result of uneven bargaining power between customers and monopolist transmission providers," FERC reasoned, "the unprecedented competitive changes that have occurred (and are continuing to occur) in the industry may render their contracts to be no longer in the public interest or just and reasonable." *Id.*

Challenging the first finding, POSCR argues that FERC lacks authority to make a *generic* public interest finding that (59)allows for contract modification in an entire class of cases. POSCR insists that FERC can only proceed on a case-by-case basis, determining in each case whether a particular contract modification is in the public interest. Even if FERC has authority to make generic findings, POSCR goes on to argue, FERC's Order 888 finding is unsupported by substantial evidence. The investor owned utilities ("IOUs") challenge the second finding, arguing that allowing customers to seek modification of all contract terms, while limiting utilities to stranded cost provisions, fails adequately to balance competing interests.

a. *FERC's authority to make a generic public interest finding*

POSCR correctly observes that FERC has pointed to no case in which a court affirmed a generic *Mobile-Sierra* finding. At the same time, POSCR has cited no case prohibiting FERC from making a generic finding, nor have we found one. In the absence of definitive authority in either direction, and given the unique circumstances of this case and our traditional deference to

FERC's expertise, we find no fault with FERC's generic determination.

The *Mobile-Sierra* doctrine "represents the Supreme Court's attempt to strike a balance between private contractual rights and the regulatory power to modify contracts when necessary to protect the public interest." *Northeast Utilities Serv. Co. v. FERC*, 55 F.3d 686, 689 (1st Cir. 1995). In *Mobile*, the Supreme Court recognized that intervening circumstances may create a situation in which contractual terms and conditions that were just and reasonable at the time the contract was executed are no longer just and reasonable. 350 U.S. at 344-45. But concluding that a utility is not typically "entitled to be relieved of its improvident bargain," the *Sierra* Court required that FERC's predecessor, the Federal Power Commission, show more than that the contract was unjust and unreasonable—the Commission had to find that contract modification was in the public interest. 350 U.S. at 355.

In most cases, intervening circumstances are unique to the relationship between contracting parties. *See, e.g. Northeast* (60)*Utilities*, 55 F.3d 686 (affirming FERC's modification to the rate schedule of a contract as a condition for approval of a merger between two parties to the contract). But where intervening circumstances—in this instance, FERC-mandated open access transmission—affect an entire class of contracts in an identical manner, we find nothing in the *Mobile-Sierra* doctrine to prohibit FERC from responding with a public interest finding applicable to all contracts of that class. Moreover, in providing for stranded cost recovery, FERC has not relieved utilities of "improvident bargains," the concern of the *Sierra* Court; rather, it has recognized that open access affects all utilities in the same manner, namely leaving them vulnerable to potentially unrecoverable stranded costs. In fact, to deny FERC authority to make generic findings in such a case would simply impose on it and the parties the repetitive burden of proving the public interest in each and every case.

In sustaining FERC's generic finding, we are influenced by the fact that before recovering stranded costs, a utility must prove that it had a reasonable expectation of continued service to a particular customer. As the IOUs intervening on behalf of FERC explain, the need to make this showing adds a particularized element to FERC's generic public interest finding. Viewed this way, Order 888's generic finding is more precisely stated as follows: It is in the public interest to allow utilities to recover stranded costs if they can prove that they had a reasonable expectation of continued service to particular customers. If a utility can demonstrate that it had a reasonable expectation of continued service to a particular customer, and incurred costs based on that expectation, then it would be against the public interest to require other customers or shareholders to bear those costs. As Order 888 explains, "the case-by-case findings that some commenters seek will, in effect, be made when the Commission determines whether to approve a proposed stranded cost amendment to a particular contract." Order 888, ¶ 31,036 at 31,813.

We stress that generic *Mobile-Sierra* findings are appropriate only in rare circumstances. Order 888 is just such a circumstance. It fundamentally changes the regulatory envi-(61)ronment in which utilities operate, introducing meaningful competition into an industry that since its inception has been highly regulated and affecting all utilities in a similar way.

b. *FERC's stranded cost public interest finding*

Having concluded that the *Mobile-Sierra* doctrine permits a generic finding in this case, we turn to POSCR's claim that the finding was unsupported by substantial evidence. POSCR faults FERC for failing to adduce evidence to support its conclusion

that denying stranded cost recovery would put particular utilities in financial peril. POSCR also thinks that the impact on customers of failing to provide for stranded cost recovery is insufficient to support a public interest finding.

With respect to POSCR's first point, it is certainly true that *Sierra* identified impairment of "the financial ability of the public utility to continue its service" as one factor supporting a public interest finding. *Sierra*, 350 U.S. at 355. Relying on this, POSCR challenges FERC's public interest finding on the ground that the record contains no individual assessments of the financial condition of public utilities.

Although public interest findings made on a case-by-case basis necessarily evaluate the harm to the particular utility seeking modification, that is not true where, as here, FERC implements a generic change in the industry. Just as that change can support a generic public interest finding, that generic finding can be supported by generic industry-wide evidence. FERC has produced such evidence. The record contains estimates of stranded costs amounting to $200 billion or more. *See* Stranded Cost NOPR, ¶ 32,507 at 32,866. It also includes comments from representatives of the financial community stating that "the prospect of not recovering stranded costs could erode a utility's ability to attract capital."

POSCR points out that eighty-five to ninety percent of the estimated $200 billion of stranded costs relates to retail sales, not wholesale sales. True enough, but we find no basis for questioning FERC's conclusion that unrecovered stranded (62)costs of even ten percent of $200 billion—the low end of the wholesale stranded cost estimate—could have serious consequences for utilities. *See* Order 888, ¶ 31,036 at 31,790. In any event, if POSCR turns out to be correct about the absence of a wholesale stranded cost problem, few utilities will avail themselves of Order 888's stranded cost recovery provisions.

POSCR's second argument focuses on FERC's finding that "if some customers are permitted to leave their suppliers without paying for stranded costs, this may cause an excessive burden on the remaining customers who, for whatever reason, cannot leave and therefore may have to bear those costs." Order 888, ¶ 31,036 at 31,811. POSCR does not agree with FERC that the failure to recover stranded costs will create an "undue burden" on remaining customers. But disagreeing with FERC is not enough. To prevail in this court, POSCR must demonstrate that FERC's prediction that failure to recover stranded costs will create an undue burden on remaining customers is unsupported by substantial evidence, *see* 16 U.S.C. § 825*l*(b), which is another way of saying it is arbitrary and capricious. *See Michigan Consolidated Gas Co. v. FERC*, 883 F.2d 117, 124 (D.C. Cir. 1989) ("[M]aking ... predictions is clearly within the Commission's expertise and will be upheld if rationally based on record evidence.") (internal quotation marks omitted). This POSCR has failed to do.

c. *FERC's public interest finding regarding customers*

The IOUs mount two challenges to FERC's second public interest finding—that it was in the public interest to allow customers to seek modification of their wholesale requirements contracts. Unlike POSCR, the IOUs make no claim that the finding lacks substantial evidence; rather, they contend that FERC's decision to allow customers to seek modification of *all* contract terms, while limiting utilities to adding stranded cost provisions, fails to balance FERC's competing concerns: respecting existing contractual commitments and accelerating the transition to competition. They also complain that FERC has failed adequately to explain (63)why affording customers this broad ability to modify their contracts is in the public interest.

FERC gave two justifications for affording customers a broader opportunity than utilities to modify their contracts, both

of which seem perfectly rational to us. First, Order 888-A explains, "these contracts were entered into during an era in which transmission providers exercised monopoly control over access to their transmission facilities." Order 888-A, ¶ 31,048 at 30,193. Also, the "unprecedented competitive changes .... may affect whether such contracts continue to be just and reasonable or not unduly discriminatory both as to the direct customers of the contracts, as well as to indirect, third-party consumers...." *Id.* at 30,193-94. In fact, Order 888 rests on the very premise that by denying competitors access to their transmission lines, utilities engaged in undue discrimination. Confined to purchasing power from their local utilities, customers suffered from this lack of access. In the natural gas restructuring, we affirmed FERC's decision to allow customers to seek to modify their sales contracts because those contracts "necessarily reflect the pipelines' monopoly power." *AGD*, 824 F.2d at 1017. The same reasons call for affirming FERC's decision here. In addition, as FERC has explained, the harm to third parties (*i.e.*, customers of the wholesale requirements customers) that may result from adherence to uneconomical contracts further justifies its conclusion. *See* Order 888-A, ¶ 31,048 at 30,194. Remedying potential unfairness to utilities by allowing them to seek stranded cost recovery if a customer shortens the term of a contract, FERC struck a balance between customers and utilities that can hardly be characterized as arbitrary or capricious.

4. *Availability of Stranded Cost Recovery to Nonjurisdictional Utilities and G&T Cooperatives*

Section 201 of the FPA gives FERC jurisdiction over "public utilities" but not over federal and state utilities. 16 U.S.C. § 824. Although FERC required utilities not subject to its jurisdiction ("nonjurisdictional utilities") to provide reciprocal open access transmission when they use a jurisdic-(64)tional utility's open access tariff, it declined to provide a mechanism for them to recover stranded costs. Explaining that it promulgated its reciprocity provision pursuant to fairness concerns, not statutory authority, FERC reasoned that it lacked jurisdiction to provide stranded cost recovery for nonjurisdictional utilities. *See* Order 888-A, ¶ 31,048 at 30,364. FERC recommended that these utilities include stranded cost provisions in their open access tariffs; those tariffs would be reviewed not by FERC but by the appropriate regulatory authority. *See id.*

Dairyland petitioners contend that FERC acted arbitrarily and capriciously in denying nonjurisdictional utilities stranded cost recovery, arguing that the same "fairness" concerns invoked by FERC to require reciprocal open access transmission require the award of stranded costs. To be sure, FERC may have had authority to include stranded cost recovery as a provision of Dairyland's open access tariff. But Dairyland has offered no reason for thinking that FERC's refusal to do so was arbitrary and capricious. Given the limited scope of FERC's stranded cost provisions, its lack of jurisdiction over entities like Dairyland, and the ability of nonjurisdictional utilities to include stranded cost provisions in their open access tariffs, we see no reason to question FERC's judgment on this issue.

The same is true with respect to the transmission-dependent utilities ("TDUs"). Like the Dairyland petitioners, they claim that FERC acted arbitrarily and capriciously by failing to provide a mechanism for them to recover stranded costs. Owning few or no transmission facilities, TDUs serve their loads using other utilities' transmission systems. Not only are TDUs nonjurisdictional utilities, but, as Order 888-A explains, open access does not cause their costs to become stranded—their customers have always had an option to use other utilities' transmission services to purchase power. *See* Order 888-A, ¶ 31,048 at 30,365.

Dairyland also contends that FERC acted arbitrarily and capriciously when it declined to treat a generation and

transmission ("G&T") cooperative and its member distribution (65)cooperatives as a single economic unit for stranded cost purposes. G&T cooperatives provide bundled wholesale power to their member distribution cooperatives, who in turn sell the power to the members' retail customers. Observing that cooperatives, unlike traditional utilities, are not vertically integrated but instead function as single economic units, Dairyland claims that G&T cooperatives have reasonable expectations of continued service to retail customers of their member cooperatives that differ substantially from the expectations public utilities have with respect to retail customers of their wholesale customers. This difference, Dairyland argues, requires FERC to allow G&T cooperatives to recover stranded costs from their member cooperatives' customers.

Rejecting Dairyland's petition for rehearing on this point, FERC noted that treating a G&T cooperative and its members as a single economic unit for purposes of stranded cost recovery would conflict with its treatment of these same cooperatives as distinct entities in its reciprocity provisions. Order 888-A, ¶ 31,048 at 30,366. There, FERC agreed with Dairyland's proposal that if a G&T cooperative seeks open access transmission from a public utility, "then only the G&T cooperative, and not its member distribution cooperatives, would be required to offer [reciprocal] transmission service." Order 888, ¶ 31,036 at 31,763. Moreover, FERC reasoned, recovering from a retail customer of a member cooperative is, in effect, recovering from an indirect customer, a situation that FERC declined to include in its stranded cost rule. *See* Order 888-A, ¶ 31,048 at 30,366.

It is true that FERC could have treated G&T cooperatives and their members as single economic units for stranded cost purposes. But FERC's explanation of why it chose not to do so, particularly the fact that G&T cooperatives and their members were treated as distinct entities for reciprocity purposes, is entirely reasonable.

5. *Challenges to Technical Aspects of Order 888's Stranded Cost Recovery Provisions*

Several petitioners mount challenges to various technical aspects of the stranded cost recovery provisions. Before (66)addressing these challenges, we emphasize the very limited scope of our review. For us to undo what FERC has done, petitioners must persuade us that FERC's actions were arbitrary or capricious. "Highly deferential," the arbitrary and capricious standard "presumes the validity of agency action." *National Mining Ass'n v. Mine Safety and Health Admin.*, 116 F.3d 520, 536 (1997). Where, as here, the issue before us "requires a high level of technical expertise, we must defer to the informed discretion of the responsible federal agencies." *Marsh v. Oregon Natural Resources Council*, 490 U.S. 360, 377 (1989) (internal quotation marks omitted). It is not enough for petitioners to convince us of the reasonableness of their views, *see UDC*, 88 F.3d at 1169 ("The existence of a second reasonable course of action does not invalidate an agency's determination."); those arguments should be presented to FERC, whose commissioners are appointed by the President and confirmed by the Senate with the expectation that they, not Article III courts, will make policy judgments.

To prevail in this court, petitioners must demonstrate that *FERC's* policy judgments are arbitrary or capricious, a heavy burden indeed. *See National Treasury Employees Union v. Hefler*, 53 F.3d 1289, 1292 (D.C. Cir. 1995) ("The 'scope of review under the "arbitrary and capricious" standard is narrow and a court is not to substitute its judgment for that of the agency.'") (quoting *Motor Vehicles Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983)). With this very deferential scope of review in mind, we turn to petitioners' arguments.

a. *POSCR's challenges to the stranded cost formula*

Reasoning that it would be burdensome to identify each and every asset that would become underutilized as a result of Order 888, FERC adopted a "revenues lost" formula to determine a departing customer's stranded cost obligation. Order 888, ¶ 31,036 at 31,839. For each year a utility can prove that it had a reasonable expectation of continued service to a particular customer, the formula calculates the customer's stranded cost obligation by subtracting the com-(67)petitive market value of the power the customer would have purchased from the utility (as estimated by the utility) from the amount the customer would have paid had it remained a generation customer of the utility (based on FERC-approved rates that the customer paid the prior three years). *Id.* At 31,839-40.

POSCR claims that this formula gives utilities no incentive to mitigate their stranded costs. Not so. The formula automatically provides such an incentive by subtracting from utilities' recovery the market price of the power—utilities that fail to sell the power at market prices will not recover their full costs. POSCR also claims that the formula fails accurately to measure stranded costs because it is based on an estimate of those costs at one point in time. Responding, FERC explained why it rejected a "true-up" provision that would have made adjustments to the amount the customer owed to reflect market conditions over the reasonable expectation period. According to FERC, such an approach would have created enormous uncertainty, outweighing any potential increase in accuracy. *See* Order 888-A, ¶ 31,048 at 30,427-28. POSCR has offered no basis for us to question this reasoning.

POSCR's claim that the formula gives utilities an incentive to minimize their estimate of the market value of the power the customer would have purchased is similarly groundless. To avoid precisely this result, Order 888 gives customers an option to either market or broker the capacity and associated energy they would have purchased from their historic utility, effectively reducing their stranded cost obligations by the difference between the actual market value of the power and the utility's estimate of the market value. *See* Order 888, ¶ 31,036 at 31,844. Order 888 also gives customers an option to substitute the price of power under the customer's contract with a new supplier for the utility's estimate of the market value. *See id.*

One final point. Throughout its brief and at oral argument, POSCR consistently referred to stranded costs as "imprudently incurred costs." Although it never developed this (68)argument, we think it worth noting that all costs included in customers' stranded cost obligations are based on FERC-approved rates and were included in utility rate bases as assignable to particular customers. To us, this means that these costs are legitimate, prudent, and verifiable.

b. *Inclusion of known and measurable costs*

The IOUs take issue with Order 888's stranded cost recovery formula because the estimate of the price the customer would have paid for the power is based on rates for the prior three years; according to the IOUs, this approach fails to consider known and measurable costs resulting from regulatory mandates that may have been deferred pursuant to filed rate schedules and FERC-approved settlements. The costs they cite include deferred costs of generation that have already been approved for inclusion in the rate base, costs relating to approved qualifying facility contracts, and government-imposed costs such as deferred taxes and nuclear decommissioning.

Although it is true that the revenue calculation measures only current rates and not deferred costs, Order 888 allows customers and utilities to file for a change in the rates before the customer's requirements contract terminates; in such cases, FERC will calculate the customer's stranded cost obligation based on those new rates. *See* Order 888-A, ¶ 31,048 at 30,427. While seeking to avoid detailed listings of specific costs that may become stranded, FERC has adequately preserved utilities' ability to include known, measurable costs in revenue estimates through a ratemaking proceeding.

c. *Treatment of energy costs in the market option*

The IOUs challenge FERC's treatment of energy costs in the market option. To mitigate utilities' incentives to minimize their estimates of the market value of the power (the competitive market value estimate or "CMVE"), Order 888 affords customers an option to buy the power stranded by their departure from the utility and resell it. Order 888, ¶ 31,036 at 31,844. Customers would purchase generation (69)capacity at the utility's estimated market value of the capacity and associated energy at average system variable cost. *Id.* At 31,845. Thus if a customer believes that a utility is underestimating the price at which it could sell the power, the customer can buy the power and then resell it. While customers exercising this option would still have to pay their stranded cost obligation as calculated under the formula, they would effectively offset the obligation by keeping the profit on the resale of the power. *Id.* At 31,845 n.879.

The IOUs contend that allowing customers to pay *average variable cost* for the associated energy is inconsistent with Order 888's definition of the CMVE, which equals the *market value* of both the generation capacity and associated energy. *See id.* At 31,839 (defining CMVE as "the utility's estimate of the average annual revenues ... that it can receive by selling the released capacity and associated energy, based on a market analysis performed by the utility"). Customers could receive a windfall, the IOUs claim, by exercising the market option although they will pay average variable cost for the associated energy, they will be able to resell it at the presumably higher market price. At the same time, utilities will be unable to recover the full market value of the power because they will be forced to sell the associated energy at cost.

Responding to this argument in Order 888-A, FERC offered two justifications for allowing customers to purchase the associated energy at average variable cost. First, because the capacity being marketed would not generally be associated with a single asset, customers exercising this option are purchasing a "slice of the system" and thus should pay average variable cost. Second, customers should be able to purchase energy at the price they currently pay, typically average variable cost. *See* Order 888-A, ¶ 31,048 at 30,433. But neither explanation responds to the IOUs' argument that defining CMVE as the market price of both the capacity and associated energy is *inconsistent with* allowing customers exercising the market option to purchase associated energy at average variable cost. In its brief in this court, FERC continues to misapprehend the IOUs' argument, largely reit-(70)erating the same arguments and failing to address the inconsistency.

The market option's stated intention is to reduce a utility's incentive to understate the CMVE. *See* Order 888, ¶ 31,036 at 31,842. If it did understate the CMVE, then customers could buy the power from the utility and resell it, keeping the difference. But FERC's policy of allowing customers to purchase the associated energy at cost gives customers an incentive to exercise the market option even when a utility has appropriately estimated CMVE because they can buy the energy at cost and resell it at the presumably higher market price. FERC's failure to explain whether it intended this result and if so, the justification

for permitting customers to receive a windfall while undercompensating utilities constitutes a failure of reasoned decisionmaking. *See AGD*, 824 F.2d at 1030 ("We do not require that FERC reach any particular conclusion; we merely mandate that it reach its conclusion by reasoned decisionmaking."). We therefore vacate this portion of the orders and remand the issue to FERC for further consideration.

d. *Rescission of notice of termination provision*

Until FERC issued Orders 888 and 889, it had required parties to power sales contracts to notify it sixty days prior to cancellation of a contract or termination of a contract by its own terms. *See* 18 C.F.R. § 35.15 (repealed by Order 888). Orders 888 and 889 eliminate the requirement that parties notify FERC in advance when a contract terminates *by its own terms*, but only with respect to contracts executed after July 9, 1996; in other cases of contract cancellation or termination, parties must still notify FERC in advance. *See* 18 C.F.R. § 35.15 (1999). TDU petitioners claim that in rescinding the notice requirement, FERC ignored the fact that utilities still have substantial market power. That some utilities retain market power in generation, however, does not undermine Orders 888 and 889. Through these orders, FERC sought to move the electricity industry toward competition; by providing an open access mechanism through which buyers may purchase power from suppliers other than trans-(71)mitting utilities, FERC substantially reduced utilities' market power. Eliminating the notice requirement furthered that policy. Moreover, customers who believe termination of their contracts is unjust can seek relief from FERC pursuant to section 206 of the FPA. *See* Order 888-A, ¶ 31,048 at 30,393.

e. *Provision for benefits lost*

The TDU petitioners claim that FERC acted arbitrarily and capriciously by failing to provide a mechanism for customers purchasing power at below-market rates to preserve those rates at the termination of their contract with their historic utility. Just as utilities may have expectations of continued service to particular customers, the TDU petitioners contend, customers may have reasonable expectations of continuing to receive wholesale requirements service from their historic utility at cost-based rates. Order 888-A says that the Commission does "not have a sufficient basis on which to make generic findings that customers under such contracts may be entitled to extend a contract at the existing rate." Order 888-A, ¶ 31,048 at 30,393 (emphasis removed). Moreover, the order explains, "the consequences of customers' expectations as a general matter would not have the potential to shift significant costs to other customers," whereas utilities' failure to recover stranded costs could potentially shift the costs to other customers. *Id.*

We think that FERC has adequately explained why it chose not to provide for benefits-lost recovery in Order 888. Most important, FERC has not foreclosed customers in this situation from seeking relief: As Order 888-A explains, a customer may "exercise its procedural rights under section 206 to show that the contract should be extended at the existing contract rate, or [ ] make such a showing in the context of a utility's proposed termination of a contract pursuant to the section 35.15 notice of termination (approval) requirement." *Id.* (footnote omitted). Given that agencies "enjoy[ ] broad discretion in determining how best to handle related, yet discrete, issues in terms of procedures ... and priorities," we think FERC's refusal to promulgate a generic rule on this issue was entirely reasonable. *Mobil Oil Explo*(72)*ration & Producing Southeast, Inc. v. United Distrib. Cos.*, 498 U.S. 211, 230 (1990).

B. *Retail Stranded Costs*

Recognizing state agency authority to address stranded costs that relate to retail power sales, Order 888 limits FERC's role as

a forum for the recovery of these costs to two situations: when customers take advantage of state-ordered wheeling to reach new power suppliers and when former retail customers become wholesale customers through what is known as municipalization or municipal annexation. *See* Order 888-A, ¶ 31,048 at 30,402, 30410. In the former scenario, FERC will consider proposals for the recovery of stranded costs only when the appropriate state regulatory commission lacks authority to do so; in the latter situation, FERC will serve as the primary forum for resolution of stranded cost claims.

1. *Stranded Costs Arising from Retail Wheeling*

Stranded costs may result from state unbundling of retail sales, where retail customers take advantage of state-ordered retail wheeling to reach new generation suppliers. *See* Order 888, ¶ 31,036 at 31,819. Observing that both FERC and the states have authority to address these stranded costs, Order 888 explains that:

> [B]ecause it is a state decision to permit or require the retail wheeling that causes retail stranded costs to occur, we will leave it to state regulatory authorities to deal with any stranded costs occasioned by retail wheeling. The only circumstance in which we will entertain requests to recover stranded costs caused by retail wheeling is when the state regulatory authority does not have authority under state law to address stranded costs when the retail wheeling is required.

Order 888, ¶ 31,036 at 31,824-25 (footnote omitted). FERC will provide for recovery of those stranded costs through the transmission rate the former supplying utility charges the departing customer. Order 888-A, ¶ 31,048 at 30,410. (As discussed in Section III *supra*, FERC has jurisdiction over

(73)the transmission component of unbundled retail sales.) In evaluating claims for stranded cost recovery, FERC will use the same standards as it applies with respect to wholesale stranded costs (*i.e.*, it will require utilities to demonstrate a reasonable expectation of continued service). *See* Order 888, ¶ 31,036 at 31,819 n.722.

Two sets of petitioners challenge FERC's retail stranded cost recovery provisions from opposite sides. The States and POSCR contend that FERC exceeded its jurisdiction by asserting rate authority over retail stranded costs. The IOUs argue that FERC abdicated its statutory authority by failing to agree to consider *all* proposals for recovery of stranded costs that arise from retail wheeling. Because we think FERC has appropriately exercised its jurisdiction, we reject both claims.

a. *FERC's jurisdiction over retail stranded costs*

The States' and POSCR's arguments boil down to the following: Because retail stranded costs relate primarily to facilities used for retail generation, and because section 201(b) of the FPA explicitly excludes these facilities from FERC's jurisdiction, FERC may not provide for recovery of these costs in FERC-jurisdictional rates. Unbundling electricity sales, they argue, cannot alter the jurisdictional status of these costs.

As an initial matter, we agree with FERC that petitioners confuse costs and rates. Rates are jurisdictional; costs are not. As Order 888-A explains:

> [T]here are rarely separate retail and wholesale generating facilities. Retail customers and wholesale requirements customers get energy from the same facilities, each buying a "slice of the system." Typically all generating assets go into both the retail and the wholesale rate bases for determining retail and wholesale rates. Rates are determined by allocating the total generating costs among customer classes. The parties confuse the issue before us to the extent they suggest that state commissions, not this Commission, have "jurisdiction" over cer-(74)tain "costs." Neither the state commissions nor this Commission has exclusive jurisdiction over "costs." Each regulatory authority has jurisdiction to determine "rates" for services subject to its jurisdiction and, in determining rates, may take into account all of the costs incurred by the utility.

Order 888-A, ¶ 31,048 at 30,414. In other words, as FERC explained in its brief, "regulatory authorities do not carve out so-called 'wholesale costs' that only FERC can take into account in determining rates subject to its jurisdiction or so-called 'retail costs' that only a state commission can take into account in determining rates subject to state jurisdiction." Instead, "[u]nder historical cost-of-service ratemaking, each regulatory authority, in exercising its respective *ratemaking* jurisdiction, reviews the *total* costs incurred by a utility to provide service and makes its separate and independent determination of what costs may be recovered through rates within its jurisdiction." Order 888-A, ¶ 31,048 at 30,414.

Thus, while petitioners correctly point out that section 201(b) of the FPA denies FERC jurisdiction over "facilities used for the generation of electric energy," that provision does not necessarily prevent FERC from including *costs* relating to generating facilities in transmission *rates*, over which FERC indisputably has jurisdiction. 16 U.S.C. § 824(b). This is so because this part of section 201(b) is modified by the phrase "except as specifically provided in this subchapter and subchapter III of this chapter." *Id.* Given that section 201(a) grants FERC jurisdiction over "the transmission of electric energy in interstate commerce" and, therefore, over transmission rates, 16 U.S.C. § 824(a), FERC may exercise jurisdiction over generation facilities to the extent necessary to regulate interstate transmission.

This is exactly the construction that we gave section 201(b) in *Mississippi Industries v. FERC*, 808 F.2d 1525, 1543-45 (D.C. Cir. 1987) (subsequent history omitted). There, petitioners challenged FERC's authority to reallocate costs relating to generation facilities among utilities that were parties to a power sales agreement. Justifying its authority to reallo-(75)cate such costs, FERC relied on its "undisputed jurisdiction over interstate sales of electric energy at wholesale." *Id.* At 1543. We agreed: "[A]lthough allocating cost does, to some extent, result in the 'regulation of matters relating to generation,' such regulation is valid under the FPA when it is the byproduct of a legitimate exercise of FERC's power to regulate wholesale rates." *Id.* In reaching this conclusion, we rejected petitioners' argument that "the statutory prohibition of federal regulation of [generation] facilities in section 201(b) becomes meaningless if FERC is permitted to allocate the costs of a plant," given FERC's undisputed responsibility to regulate the wholesale sale of power. *Id.* At 1543-44. Under *Mississippi Industries,* then, FERC may regulate costs relating to generation facilities if such regulation "is the byproduct of a legitimate exercise of FERC's power to" regulate interstate transmission. *Id.* At 1543. Because FERC indisputably has jurisdiction over transmission rates, *Mississippi Industries* also disposes of petitioners' argument that FERC's retail stranded cost recovery provisions run afoul of section 201(a) of the FPA, which provides that "Federal regulation [shall] extend only to those matters which are not subject to regulation by the States." 16 U.S.C. § 824(a).

Attempting to distinguish *Mississippi Industries*, petitioners point out that the case "involved authority to allocate generation costs to a wholesale *sales* rate (which may, of course, include generation costs)." True, but *Mississippi Industries* provides clear authority for the proposition that there is no per se *jurisdictional* bar to FERC's including generation costs in jurisdictional rates, whether wholesale sales rates or transmission rates. Thus narrowed, the question before us is this: Is inclusion of stranded costs relating to generation facilities in transmission rates the byproduct of a legitimate exercise of FERC's authority over transmission rates? In most cases the answer would be no, but given the highly unusual circumstances of this case, we think the answer is yes. Just as FERC may include generation-related *wholesale* stranded costs in transmission rates (*see* Section V.A.1.b), it may include generation-related *retail* stranded costs in transmission rates. That retail stranded costs were (76)originally reflected in state-jurisdictional retail sales rates does not change the analysis, for in both cases the stranded costs can be viewed as "costs" of providing transmission services: "While such costs are not a cost of operating the physical transmission system, nevertheless, they are an economic cost incurred as a result of being required to provide retail transmission." Order 888-A, ¶ 31,048 at 30,414 n.708. While we agree that generation-related retail costs are not typically "costs" relating to transmission services, the fundamental changes wrought by state-ordered retail wheeling, as well as the narrow circumstances in which FERC will consider stranded cost recovery claims, justify the conclusion that these costs are costs of providing transmission service.

Petitioners claim that by agreeing to consider retail stranded cost recovery claims, FERC has unduly interfered with state legislative processes and decisions. We disagree. FERC has limited its "interference" to instances where state commissions have no authority even to *address* stranded cost recovery claims. Describing its role as limited to "fill[ing] any regulatory gap," FERC made it clear that it will deny consideration to any utility seeking stranded cost recovery "if a state regulatory authority with authority to address retail wheeling stranded costs has in fact addressed such costs, regardless of whether the state regulatory authority has allowed full recovery, partial recovery, or no recovery." Order 888-A, ¶ 31,048 at 30,415. Under these circumstances, it can hardly be said that FERC has usurped state authority.

b. *FERC's refusal to assert jurisdiction over all retail stranded costs*

Contending that FERC did not go far enough, the IOUs challenge the agency's refusal to consider claims for stranded costs resulting from state-ordered retail wheeling unless the relevant state regulatory commission lacks authority to address such claims. They claim that FERC should have agreed to consider proposals for retail stranded cost recovery whether or not the state commission had authority to address the claim, and even whether or not a state commission with such authority had already addressed the claim. In support (77)of their position, the IOUs advance three related arguments. They allege first that by concluding that it had jurisdiction over retail stranded costs but declining to exercise it, FERC abdicated its legal authority. Second, they say, FERC violated its statutory obligation to ensure just and reasonable rates. And finally, they contend that FERC erred in concluding that stranded costs resulting from retail wheeling lack a direct nexus to the open access transmission ordered in Order 888.

With respect to their first argument, the IOUs claim that once FERC determined that it had jurisdiction over retail stranded costs, the agency had to exercise that jurisdiction. In making this argument, the IOUs make the same mistake POSCR made: They confuse FERC jurisdiction over *costs* with its jurisdiction over *rates*. FERC has not "concluded that it shares jurisdiction over retail stranded costs with the states," as the IOUs assert. As we explained above, "costs" are not jurisdictional. The FPA speaks not in terms of "costs," but in terms of "rates," requiring FERC to ensure that rates are just, reasonable, and not unduly discriminatory. FERC indisputably has jurisdiction over interstate transmission rates. In essence, then, the IOUs claim that FERC has no discretion to leave retail stranded cost recovery to state authorities.

We review claims that an agency lacks discretion to follow (or decline to follow) a certain course of action by examining the agency's governing statute as well as its own regulations. *See, e.g., National Wildlife Federation v. Browner*, 127 F.3d 1126, 1130 (D.C. Cir. 1997) (concluding that agency regulations do not require EPA to review and approve or disapprove a state's decision to maintain existing water quality standards); *NRDC v. EPA*, 25 F.3d 1063, 1069-70 (D.C. Cir. 1994) (holding that neither the governing statute nor relevant regulations impose a mandatory duty on EPA to list all wastes that exhibit a hazardous characteristic; statute gives EPA "substantial room to exercise its expertise in determining the appropriate grounds for listing"). The IOUs have failed to point to any statutory provision that robs FERC of discretion to decide, as a matter of policy, that state regulato-(78)ry commissions should serve as the primary forum for retail stranded cost recovery. Our own examination of the FPA reveals no such provision either. Sections of the statute giving FERC jurisdiction over transmission in interstate commerce, 16 U.S.C. § 824(a), and requiring FERC to ensure that rates are just and reasonable, 16 U.S.C. § 824d(a), do not alone create a mandatory duty to consider proposals for retail stranded cost recovery.

The two Supreme Court cases the IOUs rely on provide no support for their position, for in both cases the agencies, unlike FERC in this case, failed to comply with a specific statutory mandate. In *MCI v. AT&T,* 512 U.S. 218 (1994), the Supreme Court held that the FCC could not exempt certain communication common carriers from filing a tariff; the statute specified that *all* carriers must file tariffs. Similarly, in *FPC v. Texaco, Inc.*, 417 U.S. 380 (1974), the Supreme Court determined that the FPC could not exempt certain producers from the statute's requirement that rates be just and reasonable. Under these cases, FERC would abdicate its statutory obligations if it, for example, exempted certain utilities from the requirement that rates be just and reasonable (as in *Texaco*), or if it refused to review transmission rate filings altogether. These cases do not hold that in carrying out its statutory obligations, FERC has no discretion to determine as a matter of policy that states are better positioned to address costs originally included in retail rate bases. What the IOUs suggest—that because FERC has *authority* to address retail stranded costs through transmission rates, it must exercise that authority—is simply not the law.

As an alternative to their legal argument, the IOUs claim that FERC acted arbitrarily and capriciously in determining that just and reasonable transmission rates include retail stranded cost recovery in some circumstances but not in others. Their argument goes like this: Section 201(b)(1) of the FPA gives FERC exclusive jurisdiction over transmission of electric energy in interstate commerce. Under section 205, FERC must set just and reasonable rates. In addition, sections 205 and 206 prohibit undue discrimination. Thus, (79)the IOUs argue, "[b]y approving different transmission rates, some including stranded cost recovery (*e.g.*, municipalization), and others without (*e.g.*, retail wheeling or bypass), FERC is sanctioning arbitrary and capricious differences in violation of the FPA."

In making this argument, the IOUs ignore the wide discretion the FPA affords FERC to determine what constitute "just and reasonable rates" and "undue discrimination," as well as the unusual circumstances created by an industry change as fundamental as order 888's open access requirement. Just because some transmission rates include retail stranded costs while others do not does not alone make Order 888 arbitrary and capricious; rather, petitioners must show that there is no reason

for the difference. *Cf. AGD*, 824 F.2d at 1009 ("[T]he mere fact of a rate disparity is not enough to constitute unlawful discrimination.") (internal quotation marks omitted). We think FERC has provided a convincing explanation for the difference. "Recovery of this type of cost through a transmission rate is obviously not the norm," explains Order 888-A, "but is necessitated by the need to deal with the transition costs associated with this Rule." Order 888-A, ¶ 31,048 at 30,418. Only in situations where state regulatory commissions lack authority to award stranded costs will FERC include these costs in transmission rates. Otherwise, customers would be able to avoid their stranded cost obligations, leaving utility shareholders or remaining customers to bear the costs.

The IOUs reliance on the natural gas restructuring cases is misplaced. Setting aside the extraordinary nature of take-or-pay liabilities as compared to the stranded costs at issue here, *AGD* required only that FERC *address* the take-or-pay liabilities that the pipelines had incurred. *See AGD*, 824 F.2d at 1030 ("We do not require that FERC reach any particular conclusion; we merely mandate that it reach its conclusion by reasoned decisionmaking."). That is exactly what Order 888 does with respect to stranded costs. While FERC has not agreed to serve as the forum for recovery of these costs in all situations, neither the FPA nor the natural gas cases requires it to do so. By ensuring that utilities have a forum in which (80)to bring claims for retail stranded cost recovery, FERC has done just what *AGD* requires.

Nor do we find merit in the IOUs' argument that FERC erred in concluding that stranded costs resulting from retail wheeling lack a direct nexus to the open access transmission mandated by Order 888. FERC's decision that state regulatory commissions should address retail stranded costs rested on its conclusion that state-ordered wheeling, not FERC-mandated open access transmission, causes those costs to become stranded. *See* Order

888-A, ¶ 31,048 at 30,410. Recognizing a "limited" nexus between retail stranded costs and FERC-mandated open access stemming from FERC's jurisdiction over transmission rates and the resulting authority to award stranded costs, FERC nonetheless found *no causal nexus* between stranded costs and FERC-ordered transmission. *Id.* At 30,419. The lack of a direct causal nexus differentiates retail stranded costs from retail-turned-wholesale stranded costs (*see infra* Section V.B.2).

Taking issue with this reasoning, the IOUs contend that FERC ignored "the central role played by the federal government" in shaping the electric energy industry. Because retail wheeling, according to the IOUs, is "a direct result of a federally created system of increased competition," FERC must take responsibility for all retail stranded costs.

Nowhere does FERC contest the nexus between state-ordered wheeling and order 888's open access requirement. But the existence of a nexus does not require FERC to address retail stranded costs in light of the fact that in most instances state regulatory commissions will have authority to do so. Indeed, because the costs were originally included in retail rate bases, state agencies are better positioned to consider them. Given that it is state-ordered wheeling that most directly causes retail costs to become stranded, we find no reason to disturb FERC's judgment.

2. *Stranded Costs Relating to Retail-Turned-Wholesale Customers*

FERC concluded that open access transmission may encourage what is known as "municipalization," where a town (81) condemns a utility's distribution plant, becomes a wholesale customer of the utility, and utilizes open access transmission to purchase power on the competitive market. Concluding that costs incurred to serve former retail customers may become stranded due to the municipality's (the new wholesaler's) utilization of open access transmission, FERC decided to serve as the primary forum for resolution of stranded costs claims relating to new municipalizations. *See* Order 888-A, ¶ 31,048 at 30,402. FERC also decided to serve as the primary forum "in a discrete set of municipal annexation cases"—*i.e.*, cases involving "existing municipal utilities that annex retail customer service territories and, through the availability of Commission-required transmission access, use the transmission system of the annexed customers' former supplier to access new suppliers to serve the annexed load." Order 888-B, ¶ 61,248 at 62,102. In such cases, FERC will determine on a case-by-case basis whether there exists the requisite nexus between municipal annexation and open access transmission. Recognizing that state regulatory authorities may be the first to address claims for stranded cost recovery in the retail-turned-wholesale scenario (FERC's label for new municipalizations and municipal annexations), FERC stated that it "will take into account state findings on cost determinations ... and will give great weight in [its] proceedings to a state's view of what might be recoverable." *Id.* At 62,105 (internal quotation marks omitted).

This issue provoked the only dissents to Order 888. Although neither dissenting commissioner disputed FERC's jurisdiction to allow recovery of these stranded costs, both faulted FERC for second-guessing state authorities regarding stranded costs. They thought that FERC should have acted as the forum for adjudicating these stranded cost issues only when state authorities failed to act altogether. *See* Order 888, ¶ 31,036 at 31,904-07 (Commissioner Hoecker concurring in part and dissenting in part); *id.* At 31,907 (Commissioner Massey dissenting in part).

Unlike the dissenters, both the States and POSCR challenge FERC's assertion of jurisdiction. According to the (82)States, FERC usurped their role as protectors of retail customers by potentially undermining their rate treatment of retail costs. POSCR makes three arguments. Advancing claims similar to its arguments about stranded costs resulting from state-ordered retail wheeling (*see* Section V.B.1.a *supra*), POSCR first contends, relying again on section 201(b), that FERC lacks jurisdiction to award retail stranded costs in the retail-turned-wholesale scenario. Second, it claims, FERC failed to weigh properly the adverse effects of Order 888 on franchise competition between utilities and municipalities. Finally, relying on the Hoecker and Massey dissents, POSCR argues that FERC acted arbitrarily and capriciously by declaring itself to be the primary forum for retail-turned-wholesale stranded cost claims. For their part, the IOUs fault FERC's failure to consider claims for recovery in the so-called "bypass" scenario. We address these arguments in turn.

The States begin their argument by asserting that "[w]hen retail utility customers leave the utility's system because of municipalization, the costs stranded by the customers' migration normally are not allocable ... to whatever wholesale utility service *might* be sold to the city for resale." While this may have been true in the past, the States' argument ignores FERC's conclusion that it is open access transmission that makes municipalization feasible. Because FERC has determined that it will consider proposals for stranded cost recovery only when there is a direct nexus between municipalization and open access transmission, we see no basis for the States' claim that FERC will "override Congress's instruction that the states be permitted to protect retail customers."

The answer to POSCR's first argument—that section 201(b) precludes FERC from awarding stranded costs in the retail-turned-wholesale context—appears in our discussion of FERC's jurisdiction to address retail stranded costs resulting from state-ordered retail wheeling. *See* Section V.B.1.a *supra*. Because a town becomes a wholesale customer of the historic supplying

utility when it municipalizes, FERC's exclusive jurisdiction over all aspects of wholesale sales gives (83)FERC all the authority it needs to include generation-related costs in rates, including even costs originally incurred to provide retail service. We find no reason to question FERC's decision to allocate stranded costs caused by retail-turned-wholesale customers to the cost of providing wholesale service subject to its jurisdiction. As in the retail wheeling context, these stranded costs are properly viewed as "costs" of the former supplying utility's provision of open access transmission service. With respect to new municipalizations, the retail-turned-wholesale customer is able to reach a new generation supplier only because of open access transmission. And with respect to municipal annexations, FERC will require utilities to demonstrate a nexus between the annexation and open access transmission.

POSCR's second argument relates to what is known as "franchise competition." According to POSCR, franchise competition occurs "when a privately-owned utility is threatened by the prospect that a municipality may exercise powers of eminent domain to take over the utility's operations." POSCR argues that stranded cost recovery could impede franchise competition, which it says FERC has always encouraged. Although this might well be true, the possibility that potential stranded cost liability could deter municipalities from taking advantage of open access does not undermine Order 888. As Order 888-A explains, "the purpose of the stranded cost policy is neither to encourage nor to discourage municipalization, but rather to facilitate a fair transition to competition and to ensure stability in the industry during that transition." Order 888-A, ¶ 31,048 at 30,405.

We turn finally to POSCR's claim that FERC acted arbitrarily and capriciously by declaring itself the primary forum for recovery of retail-turned-wholesale stranded costs. Asserting that FERC's action implicitly undermines state decisionmaking and encourages forum shopping, POSCR claims that Order 888's treatment of the retail-turned-wholesale scenario contravenes agency precedent and conflicts with the agency's decision to leave to the states the consideration of those stranded costs resulting from state-ordered wheeling.

(84)While FERC did leave resolution of claims for wholesale-turned-retail stranded costs to the states in *United Illuminating Co.*, 63 FERC ¶ 61,212 (1993), a pre-Order 888 case addressing a particular utility's application for stranded cost recovery, Order 888-A explains that, after reanalyzing the stranded cost problem, FERC concluded that "where such costs are stranded as a direct result of Commission-mandated wholesale transmission access, these costs should be viewed as costs of the transition to competitive wholesale bulk power markets and this Commission should be the primary forum for addressing their recovery." Order 888-A, ¶ 31,048 at 30,407. In our view, this explanation adequately distinguishes between recovery of stranded costs from retail customers and recovery from retail-turned-wholesale customers. In the former situation customers remain retail customers subject to state jurisdiction; in the latter situation, customers become wholesale customers subject to FERC's *exclusive* jurisdiction. This very different result justifies FERC's different treatment of the two situations.

The IOUs argue that FERC should have provided for stranded cost recovery from a retail-turned-wholesale customer who ceases to purchase power from a utility but does not use that utility's transmission service to reach another power supplier—the so-called "bypass" scenario. This argument requires little discussion. In declining to provide a mechanism for the recovery of bypass stranded costs, FERC explained that "Order No. 888 does not by its terms bar the recovery of costs that do not result from the use of Commission-required transmission access. Utilities may, as before, seek recovery of such non-open-access-related costs on a case-by-case basis in

individual rate proceedings. The Commission will not prejudge those issues here." *Id.* At 30,409. Given FERC's discretion to proceed through adjudication rather than by generic rule, *see SEC v. Chenery Corp.*, 332 U.S. 194, 201-03 (1947), the IOUs' challenge is without merit.

* * *

As evidenced by the numerous petitions for review, FERC faced an enormously difficult task in fashioning a stranded (85)cost recovery mechanism that fairly compensates utilities for past investments while transitioning the electricity industry to competition. FERC has done an admirable job. Producing a comprehensive, evenhanded record and carefully considering all commenters' claims, it adopted a stranded cost recovery policy that accomplishes its stated objectives, complies with the FPA, conforms to our case law, and reasonably accommodates all competing interests. No doubt, there were alternative approaches to stranded cost recovery—petitioners have pointed to several. No doubt some aspects of Order 888 could have been better supported. But given the extremely technical nature of these issues, as well as our highly deferential standard of review, we find no basis for questioning FERC's approach. Although Order 888 may be characterized in many ways, it can hardly be said to be either arbitrary or capricious.

VI. CREDITS FOR CUSTOMER-OWNED FACILITIES AND BEHIND-THE-METER GENERATION

The Commission's Open Access Tariff requires that public utilities—or "transmission providers"—offer "network integration transmission service." This requirement is one of the key elements in the Commission's attempt to "remove impediments to competition in the wholesale bulk power marketplace," Order 888, ¶ 31,036 at 31,634. Network service allows a customer—for instance, a municipal utility—to use a transmission system in a manner comparable to the way the transmission provider utilizes its system to move power from its generators to its native load customers.[11] *See* Order 888, (86)¶ 31,036 at 31,736; *id.* At 31,751; Order 888-A, ¶ 31,048 at 30,260 n.247; *id.* At 30,325.[12] With network service, resources located throughout the system serve loads dispersed throughout the system. For this, the transmission provider incorporates the network customer's resources and loads (projected over a minimum ten-year period) into its own long term planning. Because network service ultimately provides the customer with the same full system ability for transmitting power as the transmission owner, the Commission required that costs be allocated on the basis of a ratio of the network customer's load to the transmission provider's entire load on its transmission system. A group of petitioners, led by Florida Municipal Power Agency (FMPA), challenge the Commission's use of this "load-ratio pricing."

The FMPA petitioners do not object to load-ratio pricing as such. In fact they think it "is a good method to allocate the costs of a transmission network among network owners or users,"

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[11] "Load" may be defined as "[t[he total demand for service on a utility system at any given time." PUBLIC UTILITIES REPORTS GLOSSARY FOR UTILITY MANAGEMENT 84 (1992); *see also* CARL PECHMAN, REGULATING POWER: THE ECONOMICS OF ELECTRICITY IN THE INFORMATION AGE 11 (1993). The Tariff defines "native load customers" as the "wholesale and retail power customers of the Transmission Provider on whose behalf the Transmission Provider, by statute, franchise, regulatory requirement, or contract, has undertaken an obligation to construct and operate the Transmission Provider's system to meet the reliable electric needs of such customers." Order 888-A, ¶ 31,048 at 30,508.

[12] Public utilities must also offer point-to-point service, that is, transmission service reserved and/or scheduled between specified points of receipt and delivery. Order 888-A, ¶ 31,048 at 30,508.

Brief of Credits for Customer-Owned Facilities, etc., at 3-4 ("Credits Brief"). Their principal complaint, repeated many times and in many ways throughout their briefs, stems from their view that as a practical matter the commission required that the network customer's *total* load be used in calculating the ratio,[13] even though some customers "sell power from local, 'behind the meter' generation and transmission, or ... obtain power from more than one transmission system...." *Id.* At 8.[14] The FMPA petitioners say this (87)allows "transmission providers to charge wholesale customers for network transmission that they do not want, need or use to provide electric power service to their customers." *Id.* at 18.

The Commission provided some relief in response to these complaints, but not enough to satisfy the FMPA petitioners. "Because of the diverse concerns raised by the commenters," the Commission wrote in the preamble to Order No. 888, "we are unable to resolve on the basis of this record the extent to which, or under what circumstances, cost credits related to customer-owned facilities would be appropriate under an open-access transmission tariff." Order 888, ¶ 31,036 at 31,742. Rather, this will be done on a case-by-case basis. The Commission warned, however, that mere interconnection between a customer's facilities and the transmission provider's facilities will not be sufficient to warrant a cost credit. Relying on *Florida Municipal Power Agency v. Florida Power & Light Co.*, 67 F.E.R.C.

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[13] The Commission did not actually require a customer to designate its total load to obtain network service: a customer may exclude all—not merely part—of its load at a discrete delivery point. *See* Order 888-A, ¶ 31,048 at 30,256-62.

[14] "Behind the meter generation [and transmission] means generation [or transmission] located on the customer's side of the point of delivery." Order 888-A, ¶ 31,048 at 30,254 n.230.

¶ 61,167 (1994) *(FMPA I), modified*, 74 F.E.R.C. ¶ 61,006 (1996) *(FMPA II)*, the Commission required the customer to demonstrate that its "transmission facilities are integrated with the transmission system of the transmission provider" and "provide additional benefits to the transmission grid in terms of capability and reliability, and [are] relied upon for the coordinated operation of the grid." Order 888, ¶ 31,036 at 31,742; Order 888-A, ¶ 31,048 at 30,271. The Commission did, however, guarantee credits for new, integrated transmission facilities built by a customer if jointly planned with the transmission provider.

We detect nothing in the arguments of the FMPA petitioners to warrant setting aside this aspect of the Commission's rule. It is true that as the owners of generation and transmission facilities, any one of these petitioners can satisfy some of its needs. But network service, as the Commission defined it, means that network customers can call upon the transmission provider to supply not just some, but all of their load at any given moment, when for instance they experience blackouts or brownouts. The Commission decided that if a customer does not desire such full network service for its entire load, it may exclude loads at discrete delivery points (88)and purchase point-to-point service instead. What it cannot do is split loads at delivery points. The FMPA petitioners object to the Commission's refusal to allow a split system, but their objection is not well-taken. They ignore the technical problems with a split system, stemming partly from the manner in which electrons flow and the impossibility of isolating loads from the transmission provider's system. *See FPC v. Florida Power & Light*, 404 U.S. 453 (1972). Furthermore, "such a split system creates the potential for a customer to 'game the system' thereby evading some or all of its load-ratio cost responsibility for network services." Order

888-A, ¶ 31,048 at 30,259.[15] The FMPA petitioners label this prospect a "fiction," but offer neither evidence nor reasoning to counter the Commission's expert judgment.[16]

As to credits, these petitioners maintain that if the Commission is going to use total "load-ratio pricing with Network Load defined as total customer load, simultaneous credits are required." Credits Brief at 41. What they mean by credits is reduced prices for any and all behind-the-meter facilities they own. The Commission's rejection of this blanket approach is well-supported. Credit may be given, but not automatically. The question can only be determined on a case-by-case basis because it depends on whether the customer's facilities are truly integrated with the transmission system, rather than merely interconnected. Only if they are (89)integrated will the transmission system benefit and only then, the Commission decided, should credits—which shift the costs of the customer's facilities to the transmission provider's customers—be allowed. Order 888-A, ¶ 31,048 at 30,271. Petitioners call the Commission's rule in this regard "an unexplained and inexplicable retreat from *FMPA v. FPL*." Credits Brief at 42. It is nothing of the sort. The Commission made this abundantly clear. In *FMPA I* THE Commission said that "if [a customer] has transmission facilities that will operate as part of the integrated transmission system, a credit would be reasonable." 67 F.E.R.C. at 61,482 n.76. And in *FMPA II* the Commission said that mere interconnection does not equal integration and that integration must be determined case by case. 74 F.E.R.C. at 61,010. This is completely consistent with the Commission's resolution of the credits issue in the proceedings before us.

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[15] Load-ratio cost responsibility is based on the customer's contribution to the transmission system peak each month. With a split system a customer could, at the time of the monthly system peak, increase its behind-the-meter generation in order to decrease its load-ratio cost responsibility, while making significant use of the transmission system throughout the rest of the month. *See* Order 888-A, ¶ 31,048 at 30,259 & nn.244 & 245.

[16] Petitioners claim that *Florida Power Co.*, 81 F.E.R.C. ¶ 61,247 (1997), decided after Order No. 888, shows that it is not "necessary for customers to purchase amounts of network transmission equal to their entire load behind a delivery point." Credits Brief at 30. It shows no such thing. The case involved not network integration transmission service, but a sort of hybrid service called "network contract demand transmission service."

The FMPA petitioners' next objection deals with new customer facilities—that is, those built after network service begins under the Tariff. The Commission determined that "the Network customer shall receive a credit where such facilities are jointly planned and installed in coordination with the Transmission Provider." Order 888-A, ¶ 31,048 at 30,534. Petitioners begin by reading this as some sort of "limitation," they expand it into a "condition precedent for customers to receive credit for new facilities," and they end by treating it as a bar to "credits for new customer-facilities unless they are jointly planned," Credits Brief at 43, 44, 45. Commission counsel rightly points out that petitioners have completely misread the rule: "simply put, the Rule does not speak to the situation of new facilities built outside a joint planning effort." Commission Brief at 104. The Commission did determine that a joint planning mandate was "beyond the scope of this proceeding," Order 888-A, ¶ 1,048 at 30,311. Using their mistaken premise, petitioners insist that the Commission acted arbitrarily in this regard, giving transmission providers the power to block all customer credits for new facilities. *See* Credits Brief at 45. Since their premise is mistaken, their conclusion must be rejected. The balance of (90)the FMPA petitioners' arguments have been considered and rejected.

VII. LIABILITY, INTERFACE ALLOCATION, AND DISCOUNTING

As part of Order 888, FERC adopted a pro forma Open Access Transmission Tariff (OATT), containing minimum terms and conditions for non-discriminatory service, which every transmission-owning public utility must file with the Commission and by which it must abide in providing transmission services to itself and others. Various petitioners have challenged isolated provisions of the OATT—specifically the provisions governing liability and indemnification, interface allocation, and delivery-oint specific discounting. We reject each of these challenges.

A. *Liability and Indemnification*

Prior to unbundling, retail tariffs were primarily a matter for state regulation, and most states had approved tariff provisions permitting utilities to limit their liability for service interruptions to instances of gross negligence or willful misconduct. Courts upheld these limitations on the public policy grounds that they balanced lower rates for all customers against the burden of limited recovery for some, and that the technological complexity of modern utility systems and resulting potential for service failures unrelated to human errors justified liability limitations. In the past, FERC also has allowed electric utility tariffs to explicitly limit a utility's liability for service interruptions to instances of gross negligence or willful misconduct.

One of the pro forma tariffs included in the Notice of Proposed Rulemaking contained a provision explicitly limiting the liability of transmission providers to circumstances of gross negligence or intentional wrongdoing. *See* Open Access NOPR, ¶ 32,514 at App. C § 15.0. Section 10.2 of the OATT requires the transmission customer to "at all times indemnify, defend, and save the Transmission Provider harmless from, any and all damages ... except in cases of *negligence* or intentional wrongdoing by the Transmission Provider." Order 888, ¶ 31,036 at 31,936-37 (emphasis added). In Order (91)888, FERC justified the change with a single statement: "We find that this new indemnification provision would be too strict if it required customers to indemnify transmission providers even in cases where the transmission provider is negligent." Order 888, ¶ 31,036 at 31,765.

The investor owned utility petitioners (IOUs) challenge the OATT's indemnification provision on the ground that FERC adopted the lesser ordinary negligence standard in Order 888 without first notifying interested parties that it was contemplating such a major policy change The IOUs claim that the change in the provision's language represents a significant shift in indemnification policy, in that it leaves transmission providers open to claims of ordinary negligence for the first time. The courts consistently have relied upon explicit tariff provisions to enforce the gross negligence standard for liability, *see, e.g., Southwestern Bell Tel. Co. v. Rucker*, 537 S.W.2d 326, 330-32, 334 (Tex. App. 1976); and if the tariffs do not explicitly limit liability for ordinary negligence, the IOUs claim, the courts will assess such matters differently. Because FERC's notice was not clear that the liability standard was a subject or issue of the rulemaking, the IOUs claim that FERC denied their right to comment on the change. *See, e.g., AFL-CIO v. Donovan*, 757 F.2d 330 (D.C. Cir. 1985); *McLouth Steel Prods. Corp. v. Thomas*, 838 F.2d 1317 (D.C. Cir. 1988). Citing principally our opinion in *Air Transport Association of America v. DOT*, 900 F.2d 369, 379 (D.C. Cir. 1990), the IOUs contend that the fact that they were able to raise their concerns in their petition for rehearing is not a substitute for pre-issuance notice and comment.[17]

FERC responds by denying that the indemnification provision adopts a particular liability standard at all. FERC claims that it has merely distinguished liability from indemnification, and that the change to the pro forma tariff does not establish a new, simple negligence standard of liability for transmission providers. Citing its own statements in Order (92)888-A, FERC asserts that the tariff's indemnification provision should not be construed as preempting state liability standards. *See* Order 888-B, ¶ 61,248 at 62,080-81. FERC maintains that, since the change to the indemnification provision does not represent a substantive alteration in policy or the standards governing legal liability, the Commission was not obligated to notify interested parties and seek comment. FERC accuses the petitioners of wanting FERC to impose a federal gross negligence liability standard, which FERC contends that it properly declined to do pursuant to *United Gas Pipe Line Co. v. FERC*, 824 F.2d 417 (5th Cir. 1987) (rejecting the need for a federal liability standard for pipelines).

The IOUs charged that FERC has deleted a limitation of liability to gross negligence from the existing background of utilities liability law and has done so without substantial evidence and without exercising reasoned decision making. *See Mid-Tex Elec. Coop., Inc. v. FERC*, 773 F.2d 327, 338 (D.C. Cir. 1985) (the Commission's decision must be supported by substantial evidence and be the result of reasoned decision making). The Commission denies that it has established a standard of liability nearly so sweeping as the IOUs fear. We agree with FERC's reading of the rule. While the petitioners argue that the rule works a "dramatic change" regarding the liability of electric utilities by imposing an ordinary negligence rather than a gross negligence standard that previously prevailed, in fact, the rule does not establish a new simple negligence standard of liability for transmission providers. While we read FERC's interpretation of its own rule deferentially, *see Jersey Shore Broad. Corp. v. FERC*, 37 F.3d 1531, 1536 (D.C. Cir. 1994), by any standard, its construction is correct in the present controversy. In the preamble to the regulations before us, FERC plainly describes the disputed provision as an "indemnification" provision, and recites reasoning supporting the particular indemnification provision it adopted. "[T]his new indemnification provision would be too strict if it required customers to indemnify transmission providers even in cases where the transmission provider is negligent." Order 888, ¶ 31,036 at 31,765. In the preamble to Order 888-A, in a section concededly headed "*Liability* and Indemnification" (emphasis added), FERC explains the later version of the relevant provisions in terms consistent with the Order 888 preamble. *See generally* Order 888-A, ¶ 31,048 at 30,299-302. Finally, in Order 888-B, FERC summarizes its reasoning for its indemnification and liability decisions, again both adequately and in ways not amounting to the adoption of the universal standard as asserted by the IOUs. *See generally* Order 888-B, ¶ 51,248 at 62,079-81. In short, FERC's rule does not work so sweeping a change in the legal landscape as the IOUs assert, and FERC has exercised reasoned decisionmaking in support of such pronouncements as it has made.

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[17] We recognize that *Air Transport* has been vacated. *See Air Transport Association of America v. DOT*, 933 F.2d 1043 (1991) (per curiam).

Insofar as the IOUs challenge the adequacy of FERC's notice in the NOPR that it was contemplating a change in the indemnification and liability provisions of pro forma tariffs, that challenge also fails. It is well established that a final rule need not be identical to the original proposed rule. *See, e.g., AFL-CIO v. Donovan*, 757 F.2d at 338; *Trans-Pacific Freight Conference v. Federal Maritime Comm'n*, 650 F.2d 1235, 1249 (D.C. Cir. 1980). Were the change between the proposed and final rule an important one, we would have to ask whether the final rule is a logical outgrowth of the proposed one. *See, e.g., National Mining Ass'n v. Mine Safety & Health Admin.*, 116 F.3d 520, 531 (D.C. Cir. 1997). Not all changes are sufficiently important to warrant such scrutiny and concern, however. "An agency, after all, must be free to adopt a final rule not described exactly in the [notice of proposed rulemaking] where the difference is sufficiently minor, or agencies could not change a rule in response to valid comments without beginning the rulemaking

anew." *National Cable Television Ass'n v. FCC*, 747 F.2d 1503, 1507 (D.C. Cir. 1984).

We agree with FERC that its indemnification provision does not preclude the states from shielding utilities from liability for ordinary negligence. States did so before, through both their regulatory commissions and their courts; and they remain free to do so under Order 888. The deletion of the gross negligence language from the pro forma tariff's indemnification provision does not significantly change the (94)petitioners' legal position. Therefore, contrary to the IOUs' challenge, the deviation of the final rule from the proposed one is not a major one; and FERC's failure to notify interested parties that it was considering the change does not render the provision arbitrary or capricious under the APA. Accordingly, we affirm this portion of the pro forma tariff.

B. *Interface Allocation*

The IOUs also challenge FERC's treatment of interface allocation as unsupported by the record and contrary to reasoned decision making. Section 30.8 of the pro forma tariff addresses how much of a transmission provider's interface capacity a network customer can use. *See* Order 888, ¶ 31,036 at 31,954-55. Interface capacity represents the capability of a transmission facility to transfer power between two utilities. Section 30.8 permits a network customer to use a transmission provider's capacity to the extent of the network customer's total load without limitation.

In the rulemaking process, several parties argued that a fair method of interface allocation would be the use of a load ratio, under which the transmission provider and each network customer would be allocated a share of each specific interface based upon their respective loads. Nevertheless, in Order 888, FERC ruled that network customers could use any of the transmission providers' interfaces to import up to their full load on a first-come, first-served basis. The IOUs maintain that this ruling does not promote an equitable allocation of a transmission provider's interfaces.

The IOUs also note that, responding to the IOUs petition for rehearing on this issue in Order 888-A, FERC merely referenced *Florida Municipal Power Agency v. Florida Power & Light Co.*, 74 F.E.R.C. ¶ 61,006 (1996) (hereinafter *FMPA II*), to support its conclusion, without addressing either the comments or the rehearing petitions. FERC meanwhile maintains it found the load ratio share method advocated by some transmission owners to be unreasonable for the same reasons discussed at length in *FMPA II*. Intervenors add that the IOUs' challenge of the aggregate, (95)first-come, first-served approach adopted by FERC as inequitable merely reflects a disagreement with FERC's policy choice.

Whether to adopt a load ratio share approach or an aggregate, first-come, first-served approach to capacity allocation is a matter of policy. Again, the IOUs have not challenged FERC's legal authority to select a particular interface allocation method, but rather whether FERC's choice was based upon reasoned decision making. Accordingly, we evaluate FERC's treatment of interface capacity allocation under the APA's arbitrary and capricious standard. *See* 5 U.S.C. § 706(2)(A) (1994).

FERC's analysis of the issue in the present rulemaking consists solely of a reference to and quotation from its earlier decision in *FMPA II*. *See* Order 888-A, ¶ 31,048 at 30,304-05. That proceeding involved an application by Florida Municipal Power Agency for open access to Florida Power & Light Company's transmission facilities pursuant to FPA §§ 211 and 212. *See FMPA II*, 74 F.E.R.C. ¶ 61,006 at 61,004; *see also Florida Mun. Power Agency v. Florida Power & Light Co.*, 67

F.E.R.C. ¶ 61,167 (1994) (hereinafter *FMPA I*). In *FMPA I* and *FMPA II*, FERC justified its choice of policies as follows:

> [T]here are no restrictions on the use of other parts of the transmission system. If the interfaces are constrained, Florida Power and FMPA should simply redispatch and share the redispatch costs and, ultimately, Florida Power will build new facilities when needed. The interfaces are just another part of the transmission grid, and Florida Power must plan and operate the grid, including the interfaces, to meet the combined needs of Florida Power and FMPA on an equal basis. When there are conflicting needs to use the same interface capacity, the parties have already agreed that the combined Florida Power and FMPA systems will be redispatched and the costs shared. When the grid, including interfaces, needs to be expanded, Florida Power will undertake the expansion on behalf of the combined system.

(96)*FMPA II*, 74 F.E.R.C. ¶ 61,006 at 61,018 (quoting *FMPA I*, 67 F.E.R.C. ¶ 61,167 and 61,484. While FERC's recognition of the petitioner's concerns was certainly cursory, and its language in *FMPA II* is slightly oblique, FERC has adequately demonstrated that it gave full consideration before rejecting load ratio share in favor of aggregate, first-come, first-served capacity allocation. Accordingly, we uphold FERC's ruling on the interface capacity allocation issue.

C. *Delivery-Point-Specific Discounting*

Two groups of transmission dependent utilities, TAPS and TDU Systems, and the nation's largest power wholesaler, Enron Power Marketing (collectively the U&D petitioners), challenge FERC's decision to permit delivery-point-specific discounting.

Electric utilities often offer both firm and non-firm service. Firm service permits customers to demand transmission at any time, while non-firm service permits the utility to cut service when there is not enough excess capacity.

In Order 888, FERC allowed transmission providers to offer discounted rates for non-firm service only if they gave the same discounted rate to all customers for the same transmission path and on all other unconstrained transmission paths. *See* Order 888, ¶ 31,036 at 31,743-44. FERC also required that the discounts be posted in advance so that all customers could have equal opportunity to take advantage of the discounted rate. *See id.* at 31,744. In Order 888-A, FERC narrowed the requirement, so that a transmission provider offering a discount on a particular path need only provide the same discount to all other unconstrained paths that go to the same delivery point in the provider's system. *See* Order 888-A, ¶ 31,048 at 30,275-76. FERC also said that a transmission provider should discount only if necessary to increase throughput on its system. *See id.* at 30,274.

The U&D petitioners contend that delivery-point-specific discounting results in higher transmission rates for transmission dependent utilities (TDUs), who rely on point-to-point service rather than network service for their transmis(97)sions. Delivery-point-specific discounting permits transmission facility owners to select the delivery points for which they will discount firm and non-firm service. The U&D petitioners argue that this discounting method allows transmission facility owners to discriminate by denying discounts to the delivery points used by the TDUs, thereby raising the transmission costs of these competitors, and in turn decreasing competition at both retail and wholesale.

Additionally, because of the subordination and interruptibility of non-firm service, the U&D petitioners claim that FERC's longstanding pricing policies utilized discounting as the mechanism for ensuring that non-firm service was priced below firm service. The notice of proposed rulemaking emphasized FERC's reliance on non-discriminatory discounting to achieve higher firm service rates than non-firm rates, so that non-firm rates would reflect the interruptibility of transmission services and be economically efficient. The petitioners argue that FERC's decision in Order 888 to deny discounting of non-firm rates unless firm rates are also discounted an unexplained reversal of that longstanding pricing policy. By adopting a deliver-point-specific discounting rule, the petitioners claim that FERC subjects TDUs to firm rates for all non-firm service. As a result, the petitioners contend, the price that TDUs have to pay for non-firm service does not reflect the interruptibility of that service. The petitioners maintain that this aspect of FERC's order itself represents undue discrimination, and that FERC failed to explain why it rejected a compromise position which would restrict opportunities for discrimination and address concerns that the new rules discourage discounting.

FERC notes that it discussed the discounting issue in Orders No. 888, 888-A, and 888-B. *See* Order 888, ¶ 31,036 at 31,743-44; Order 888-A, ¶ 31,048 at 30,272-76; Order 888-B, ¶ 61,248 at 62,072-75. FERC accuses the petitioners of wanting the Commission to require transmission providers to discount all non-firm services below firm rates regardless of the facts of the particular case. FERC asserts that it did not seek to discourage discounting, but was concerned that if it required discounting on all unconstrained paths as a condition (98)for offering discounts, transmission providers would be discouraged from offering any discounts at all. Fewer discounts could lead to decreased use of transmission services, and therefore a decline in overall transmission revenues, and a corresponding increase in transmission rates to enable transmission providers to recover their costs. FERC maintains that the petitioners, like everyone else, retain the opportunity to compete with the transmission provider for power sales to the same delivery point at the same discounted rate. FERC argues that its orders are consistent with its established pricing policy of permitting flexibility to reflect interruptibility and efficient use of the transmission system, subject to the firm price cap. In most case, FERC expects that non-firm transmission rates will be priced below the firm rate.

Although the petitioners hint at a statutory claim by alleging that FERC's orders result in undue discrimination and higher rates in violation of the FPA's statutory mandate, the petitioners generally confine themselves to arguing that FERC's decisions to permit delivery-point-specific discounting and non-firm rates equal to firm rates represent unexplained departures from established policy. We therefore analyze this issue under the arbitrary and capricious standard of the APA. *See* 5 U.S.C. § 706(2)(A).

With respect to non-firm versus firm rates, the cases cited by the petitioners as demonstrating a previously established discounting policy actually establish that FERC addresses this issue on a case-by-case basis. For example, in *Kentucky Utilities Co.*, 15 F.E.R.C. ¶ 61,002 (1981), FERC said that the utility could not allocate capacity costs to non-firm transmission service since such service did not factor into the utility's capacity decisions. In contrast, in *Central Maine Power Co.*, 60 F.E.R.C. ¶ 61,285 (1992), while FERC noted that non-firm service generally warrants a rate lower than firm service, FERC also upheld the utility's decision not to offer non-firm rate discounts on several contracts. Indeed, the petitioners acknowledge that FERC's pre-Order 888 Transmission Pricing Policy Statement, 59 Fed. Reg. 55,031 (1994), does not (99)expressly require non-firm rates to be priced below firm rates in all cases. *See* Br. of U&D Petitioners at 24 n.30.

The petitioners cite *American Electric Power Service Corp.*, 82 F.E.R.C. ¶ 61,090 (1998), for the proposition that, after

adopting delivery-point-specific discounting, FERC has refused to consider whether non-firm rates should be lower than firm rates; but in that case, FERC did consider that issue, found the rates in question to be nondiscriminatory, and refused only to consider the petitioners' generic challenges to its broader policy of flexibility. Additionally, the petitioners charge that FERC's acceptance of firm rates for non-firm service conflicts with this court's decision in *Fort Pierce Utilities Authority v. FERC*, 730 F.2d 778, 788-89 (D.C. Cir. 1984); but in that case, this court merely noted that FERC had failed to reconcile its decision to allocate capacity costs to non-firm transmission service with its previous refusal to do so in *Kentucky Utilities*, and remanded for further consideration. In short, FERC does not appear to have changed its overall pricing policy at all, except to fine tune its guidance as to when discounting might be considered discriminatory.

Which brings us to whether delivery-point-specific discounting in fact discriminates against the TDUs. Essentially, FERC and the petitioners offer conflicting discounting theories, both of which seem plausible. In its request for rehearing, TAPS observed that, by allowing transmission providers to select which delivery points merit discounts, FERC permits the providers to select for discounting those delivery points which serve their affiliates, and not to select the similarly situated delivery points which serve the TDUs. On rehearing, FERC quite logically maintained that requiring transmission providers to apply discounts to all unconstrained transmission paths could discourage discounting generally, resulting in higher rates for all. *See* Order 888-A, ¶ 31,048 at 30,275. FERC subsequently asserted that requiring transmission providers to offer the same discount for the same time period on all unconstrained paths that go to the same (100)delivery point will achieve sufficient comparability. *See* Order 888-B, ¶ 61,248 at 62,075. FERC noted that it will be able to monitor the discounting behavior of transmission providers for discrimination through the data posted on OASIS. *See id.*

The record reflects that FERC considered fully all of the arguments, and concluded that delivery-point-specific discounting best accomplished comparability while encouraging discounting. Thus, the discounting policies outlined in Orders 888, 888-A, and 888-B are not arbitrary or capricious. We therefore affirm FERC's resolution of this issue.

VIII. TARIFF TERMS AND CONDITIONS

A. *Headroom Allocation*

Firm point-to-point service, as distinguished from network service, is transmission service reserved and/or scheduled between specified points of receipt and delivery. *See* Order 888-A, ¶ 31,048 at 30,508. Point-to-point customers may not need all the service for which they contracted. The Commission decided that they may, without extra charge, use their excess capacity to make firm sales between the receipt and delivery points specified in their agreement. Section 22.1 of the Tariff gives them another option for dealing with this "headroom." The point-to-point customer may, without charge, have the public utility provide transmission on a non-firm basis over receipt and delivery points other than those specified in the service agreement (so-called "secondary" points).

Network customers describing themselves as Transmission Dependent Utilities (TDUs) contend that the flexibility given to point-to-point customers to sell their unused capacity should also be given to them. Three transmission providers[18]—the CPL

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[18] Carolina Power & Light Company (CPL), Florida Power & Light Company and Niagara Mohawk Power Corporation.

petitioners—want restrictions placed on point-to-(101)point customers in order to avoid putting the customers at a competitive advantage. The Commission refused to adopt these proposals for reasons we believe are sound.

As to transmission providers, the Commission noted that if they want to make off-system sales they too must take point-to-point service; in doing so they gain the same flexibility as regular point-to-point customers. *See* Order 888, ¶ 31,036 at 31,751. For network customers, the Commission stated that they "are not obligated to take network transmission service" and if they "want to take advantage of the as-available, non-firm service over secondary points of receipt and delivery through the point-to-point service, they may elect to take firm point-to-point transmission service in lieu of the network service." Order 888-A, ¶ 31,048 at 30,253. The Commission properly insisted on maintaining its basic distinctions between network service and point-to-point service. Unlike a point-to-point customer, a network customer's rights are defined in terms of capacity needed, and thus "vary as the customer's load varies," rendering them not sufficiently definite and defined to be "reassignable in the secondary market." *Id.* at 30,223. At least one of the TDUs agreed with the Commission "that, because there is no fixed capacity reservation for network customers, allowing them unrestricted use of capacity to make off-system sales without additional charge would give such customers a competitive advantage over [point-to-point] customers." Terms and Conditions Brief at 11.[19]

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[19] These petitioners add that the Vermont Department of Public Service (VDPS) offered a solution to the problem but the Commission overlooked it. Terms and Conditions Brief at 12. This is not correct. The Commission did consider the Vermont proposal, finding it to be an "artifice derived from the load ratio share calculation," a "formula [that] does not result in a reassignable capacity right." Order 888-A, ¶ 31,048 at 30,223.

B. *Headroom Prioritization*

Some petitioners complain that secondary non-firm point-to-point customers should not have been placed in a status below non-firm point-to-point customers and that the Com-(102)mission offered no explanation for its doing so. *See* Terms and Conditions Brief at 14-17. The Commission did explain itself. Firm point-to-point customers are permitted to designate secondary receipt and delivery points at no extra charge and therefore "are properly accorded a lower priority than stand alone, non-firm transmission." Order 888-A, ¶ 31,048 at 30,281. Furthermore, the Commission promised to reevaluate its approach in response to any "future transmission rate proposal that is based on the concept of tradable capacity rights," but it was moving cautiously because in the electric utility industry (unlike the natural gas industry) such "trading rights simply do not exist at this time." *Id.*

C. *Duplicative Charges*

The TDU petitioners argue that the new rules cause them to be double-charged in certain transactions. They first object to the Commission's decision that in power exchanges (flows in one direction for a time and then flows in the opposite direction) each party must reserve and pay for transmission along the same path. *See* Terms and Conditions Brief at 18. The Commission's response was that traditionally and "from the transmitting utility's planning and reservation perspective," the power exchange consists of two one-way transmission services. Commission Brief at 115. Petitioners offer no legal basis for us to prefer their treatment to that of the agency and so we will not disturb the Commission's approach.

Petitioners' second objection is that the Tariff double counts network load served by two separate energy suppliers because, "[i]f two separate suppliers purchase network service to supply

a portion of the load for a particular customer, the entire load of the customer is included in calculating the reservation charges paid by both supplying network customers, unless each load portion is isolated electrically from the other." Terms and Conditions Brief at 21. We confess to some difficulty in comprehending petitioners' complaint. It seems perfectly reasonable to answer, as the Commission's counsel does, that "there is no rational basis for both the network transmission customer and its power marketer sup-(103)plier to designate the same load under the Tariff." Commission Brief at 115. The power supplier itself may, the Commission pointed out, purchase network service; we cannot see why both the power supplier and the power buyer would purchase such service when a purchase by either would suffice. Petitioners seem to concede that in some instances the double-counting problem could be avoided in this manner, yet they think that in some other, ill-defined circumstance it could not. This rulemaking set forth the standard tariff terms. If petitioners, or any one of them, have some unique circumstances warranting an adjustment, there will be time enough for them to seek relief from the Commission.

D. *Multiple Control Areas*

Network customers may wish to serve loads in two or more control areas. Some commenters were concerned that such customers would have to pay a network transmission rate to two or more transmission providers based on the customer's total load. *See supra* Section VI (credits for customers). The Commission had several responses. First, the risk could be avoided or alleviated by the customer's purchasing point-to-point service, or a combination of network and point-to-point service at discrete delivery points (thereby reducing its load ratio). Or the customer could purchase network service alone in each transmission provider's control area. *See* Order 888-B, ¶ 61,248 at 62,096 n.157. If the customer insists on foregoing the last option, it can hardly expect that the additional service it is demanding—the moving of power from one transmission provider's system to another system—should be free of charge. As the Commission put it:

> Because the additional transmission service to non-designated network load outside of the transmission provider's control area is a service for which the transmission provider must separately plan and operate its system beyond what is required to provide service to the customer's designated network load [within the control area], it is appropriate to have an additional charge associated with the additional [point-to-point] service.

(104)Order 888-A, ¶ 31,048 at 30,255, *quoted in* Order 888-B, 81 F.E.R.C. ¶ 61,248 at 62,096. This is consistent with the handling of an analogous situation involving separate transmission systems in the past. *See Fort Pierce Utils. Auth. v. FERC*, 730 F.2d 778, 781-85 (D.C. Cir. 1984).[20]

E. *Right-of-First-Refusal*

In order to preserve the certainty and continuity of transmission service, the Commission granted existing customers a right-of-first-refusal (ROFR) upon the expiration of firm contracts exceeding one year provided that the existing customer agreed to match the contract price and term of any party competing for that service. *See* Order 888, ¶ 31,036 at 31,665. The Commission did not set an upper limit on the terms that a

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[20] Petitioners claim that the Commission failed to consider a particular proposal related to this subject. *See* Terms and Conditions Brief at 33. It is unnecessary to describe the proposal. All that need be said is that the Commission rejected a nearly identical proposal and gave its reasons for doing so. *See* Order 888-B, ¶ 61,248 at 62,096.

competing party could offer, but chose instead to allow the market to determine rates and terms. Petitioners argue that the Commission's failure to establish an upper limit should be set aside and remanded for further consideration. The Commission conceded error on this point at oral argument in light of *United Gas Distribution Cos. v. FERC*, 88 F.3d 1105, 1138-40 (D.C. Cir. 1996). We therefore remand this matter to the Commission so that it may provide a reasonable cap on contract extensions.[21]

(105)IX. NATIONAL ENVIRONMENTAL POLICY ACT AND REGULATORY FLEXIBILITY ACT COMPLIANCE

A. *NEPA Compliance*

One investor-owned utility, Public Service Electric & Gas Company ("PSE&G"), claims that FERC failed to comply with the National Environmental Policy Act ("NEPA"), 42 U.S.C. §§ 4321 *et seq.* It argues first that the base case FERC adopted to evaluate the effects of open access transmission was unreasonable because it "defined away" the effects of open access. Second, it argues, FERC acted arbitrarily and capriciously by failing to undertake measures to mitigate the environmental impact of Order 888.

1. *Adequacy of Base Case*

NEPA requires federal agencies contemplating a major action "significantly affecting the quality of the human environment" to prepare a thorough analysis of the action's environmental impact. 42 U.S.C. § 4332(C). The statute requires that environmental impact studies include "a detailed statement ... [of] alternatives to the proposed action." *Id.* § 4332(C)(iii).

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[21] The TDU petitioners stated in their reply brief that Commission counsel's explanation of § 13.2 of the Tariff, as amended in Order No. 888-A and as interpreted in *Madison Gas & Electric Co.*, 82 F.E.R.C. ¶ 61,099 at 61,372 (1998), to apply only to short term customers satisfies their objection. *See* Terms and Conditions Reply Brief at 25. The remaining arguments of these petitioners not discussed in this part or in part V have been considered and rejected.

In its environmental impact study prepared in connection with Order 888, FERC identified as the base case alternative a scenario that "maintains] the status quo." FERC Final Environmental Impact Statement, *Promoting Wholesale Competition through Open Access Non-discriminatory Transmission Services by Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities* at 2-1 (Apr. 1996) ("*FEIS*") Under that scenario, FERC would continue on a case-by-case basis to (1) condition approval of mergers and applications for sales at market rates on the filing of open access tariffs and (2) approve open access wheeling orders under section 211 of the FPA. *Id.*

Several commenters (including EPA) argued that FERC should adopt as its base case an alternative that freezes the status quo, *i.e.*, assumes that no further open access transmission of any kind occurs and that efficiency in the industry remains unchanged. *See id.* at 6-1. Characterizing this (106)"frozen efficiency" case as unreasonable, FERC declined to adopt it as the base case. *See id.* at 6-9-6-14. It nevertheless conducted sensitivity analyses comparing emissions under the frozen efficiency case with those under its base case. This comparison revealed "modest" reductions in emissions under the frozen efficiency case in certain circumstances. *Id.* at 6-4. When market conditions favor coal versus natural gas, NO_x emissions under the base case are higher than under the frozen efficiency case by two percent in 2000, three percent in 2005, and five percent in 2010. *Id.* at 6-15. But when market conditions favor gas, the base case produces more favorable environmental benefits for all three years. *Id.* at 6-17.

We evaluate agency compliance with NEPA under a rule of reason standard. "[A]s long as the agency's decision is 'fully informed' and 'well-considered,' it is entitled to judicial deference and a reviewing court should not substitute its own policy judgment." *Natural Resources Defense Council, Inc. v. Hodel*, 865 F.2d 288, 294 (D.C. Cir. 1988) (quoting *North Slope Borough v. Andrus*, 642 F.2d 589, 599 (D.C. Cir. 1980)).

PSE&G argues that FERC, in adopting its base case, "defined away" the impact of open access by comparing the environmental effects that would result from immediate implementation through Order 888 to those that would result from gradual implementation. Calling FERC's evaluation of the frozen efficiency case "cursory," PSE&G contends that the proper no action base case is not to implement open access at all.

Given the terms of NEPA and our highly deferential review, we think FERC's FEIS complied with the statute. For one thing, NEPA does not require that a certain alternative be adopted as the base case. Rather, NEPA requires that agencies include in their FEIS analysis of "alternatives to the proposed action." 42 U.S.C. § 4332(C)(iii). Thus there is no merit to the contention that NEPA requires FERC to adopt the frozen efficiency case as the base case. We agree with PSE&G that one of the alternatives NEPA requires FERC to consider is the alternative of no action. (107)But based on our own examination of the FEIS, we think that FERC devoted sufficient attention to evaluating the frozen efficiency case (what PSE&G calls the no action alternative) to satisfy NEPA's requirements. In conducting sensitivity analyses to its base case, FERC identified the changes in both NO_x and CO_2 emissions that the frozen efficiency case would produce. Given that FERC's comparison of the frozen efficiency case to its base case yielded little difference, the agency had no reason to conduct further analysis. By rigorously examining the frozen efficiency case, even though it believed the case to be unreasonable, FERC ensured that its decision was "fully informed" and "well-considered." *Hodel*, 865 F.2d at 294.

2. *Failure to Adopt Mitigation Measures*

PSE&G argues that FERC acted arbitrarily and capriciously by failing to adopt measures to mitigate the expected harmful environmental effects of Order 888. Noting that an agency must consider mitigation if the proposed action would result in adverse environmental impacts, FERC considered but ultimately rejected any mitigation measures. *See FEIS* § 7. In reaching this conclusion, FERC relied on (1) the fact that any mitigation measures it might undertake are unwarranted in view of Order 888's small impact (especially given that its effects are as likely to be beneficial as harmful) and (2) its lack of expertise in atmospheric chemistry, together with the fact that any impact of open access would be "dwarfed by the far larger existing ozone and NO_x emission issues" currently being dealt with by EPA under its Clear Air Act authority. *FEIS* at 7-47-7-48.

The heart of PSE&G's challenge is this: downwind utilities, which are subject to NO_x reduction requirements, will face increased compliance costs due to the purported increase in emission levels resulting from Order 888; by comparison, upwind utilities that generate the pollution but are not subject to NO_x reduction requirements will experience no increased costs. PSE&G insists that FERC remedy this "undue preference" for upwind utilities.

(108)Given that FERC has identified only small increases in emissions resulting from open access transmission—indeed, under some circumstances, the Commission predicted small decreases—we think it was entirely reasonable for FERC to decline to adopt mitigation measures to address a problem that it believed might not even develop. Not relying solely on Order 888's relatively insignificant environmental impact, however, FERC comprehensively analyzed proposed mitigation measures, explaining why it declined to require any. In light of this thorough analysis, we think FERC's conclusion—that NO_x emission increases resulting from Order 888, if any, are best addressed by EPA and the states through a comprehensive emissions control program—is hardly arbitrary or capricious. We therefore have no need to resolve the parties' debate about FERC's legal authority to order environmental mitigation.

PSE&G also argues that FERC employed unreasonable assumptions in the FEIS and ignored its own data showing adverse environmental impacts. In our view, these arguments amount to an effort by PSE&G to substitute its own analysis for FERC's. To prevail in this court, it must demonstrate that FERC's analysis is arbitrary and capricious, a showing it has fallen far short of making.

B. *Regulatory Flexibility Act Compliance*

The Regulatory Flexibility Act requires agencies to conduct a regulatory flexibility analysis for any final rule. The Act exempts agencies from this requirement if they certify that "the rule will not, if promulgated, have a significant economic impact on a substantial number of small entities." 5 U.S.C. § 605(a)-(b). Invoking this exemption, FERC certified that both Order 888 (open access) and Order 889 (OASIS and standard of conduct rules) would have no such impact. Order 888, ¶ 31,036 at 31,896; Order 889, ¶ 31,035 at 31,628.

The TDU petitioners claim that FERC failed adequately to consider the impact of Orders 888 and 889 on nonjurisdictional entities that may have to provide open access transmission and file open access tariffs under the orders' reciprocity provisions. In contrast to jurisdictional utilities, several non-(109)jurisdictional utilities are classified as small entities. According to TDU petitioners, the orders impose a significant economic burden on them, requiring compliance activities as well as alterations to their operations.

Although the RFA's judicial review provision was amended in 1996, *see* Small Business Regulatory Enforcement Fairness Act, Pub. L. No. 104-121, tit. II, 110 Stat. 857 (1996), the TDU petitioners and FERC agree that the pre-amendment version of the RFA applies in this case. Under that version, our review is quite narrow. Section 611(b) provided that "[a]ny regulatory flexibility analysis ... and the compliance or noncompliance of the agency with the provisions of this chapter shall not be subject to judicial review. When an action for judicial review of a rule is instituted, any regulatory flexibility analysis for such rule shall constitute part of the whole record of agency action in connection with the review." 5 U.S.C. § 611(b) (1994). We have interpreted this language to mean that "'a reviewing court should consider the regulatory flexibility analysis as part of its overall judgment whether a rule is reasonable and may, in an appropriate case, strike down a rule because of a defect in the flexibility analysis.' We emphasize[ ], however, that 'a major error in the regulatory flexibility analysis may be, but does not have to be, grounds for overturning a rule.'" *Mid-Tex Elec. Co-op, Inc. v. FERC*, 773 F.2d 327, 340-41 (D.C. Cir. 1985) (quoting *Small Refiner Lead Phase-Down Task Force v. EPA*, 705 F.2d 506, 537-39 (D.C. Cir. 1983)).

In this case, FERC explained that Orders 888 and 889, considered in their entirety, do not have a "significant" impact on a "substantial" number of small entities. According to FERC, the orders will affect nonjurisdictional utilities only in the limited situation where they take advantage of a jurisdictional utility's open access transmission tariff. Given our highly deferential standard of review, and given the fact that petitioners have offered nothing other than their own views to the contrary, we have no basis for questioning FERC's judgment.

(110)FERC, moreover, was not insensitive to the potential impact of Order 888 on small nonjurisdictional entities. Order 888 contains a waiver provision allowing these entities to seek an exemption from compliance with the reciprocity conditions. *See* 18 C.F.R. § 35.28(e)(2) (allowing nonjurisdictional utilities to file a request for waiver "for good cause shown"). As of March 1997, FERC had granted waivers to thirty-six small entities. *See* Order 888-A, ¶ 31,049 at 30,578.

Most important in view of our standard of review, nothing in petitioners' arguments causes us to question the reasonableness of the reciprocity provisions themselves. *See Mid-Tex*, 773 F.2d at 340-41. We therefore affirm FERC's RFA certification.

CONCLUSION

In summary, we affirm Orders 888 and 889 in all respects except as specifically provided above.

APPENDIX D

Section 31,036 Federal Energy Regulatory Commission Regulations Preambles (Order 888)

[¶31,036]

61 F.R. 21540 (May 10,1996)
18 CFR Parts 35 and 385
[Docket Nos. RM95-8-000 and RM94-7-001; Order No 888]

Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities.

Issued April 24, 1996

AGENCY: Federal Energy Regulatory Commission, DOE.

ACTION: Final rule.

SUMMARY: The Federal Energy Regulatory Commission (Commission) is issuing a Final Rule requiring all public utilities that own, control or operate facilities used for transmitting electric energy in interstate commerce to have on file open access non-discriminatory transmission tariffs that contain minimum terms and conditions of non-discriminatory transmission tariffs that contain minimum terms and conditions of non-discriminatory service. The Final Rule also permits public utilities and transmitting utilities to seek recovery of legitimate, prudent and verifiable stranded costs associated with providing open access and Federal Power Act section 211 transmission services. The Commission's goal is to remove impediments to competition in the wholesale bulk power marketplace and to bring more efficient, lower cost power to the Nation's electricity consumers.

EFFECTIVE DATE: This Final Rule will become effective on July 9. 1996.

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SUPPLEMENTARY INFORMATION: In addition to publishing the full text of this document in the Federal Register, the Commission also provides all interested persons an opportunity to inspect or copy the contents of this document during normal business hours in the Public Reference Room at 888 First Street, NE., Washington, DC 20426.

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I. Introduction/Summary

Today the Commission issues three final, interrelated rules designed to remove impediments to competition in the wholesale bulk power marketplace and to bring more efficient, lower cost power to the Nation's electricity consumers.[1] The legal and policy cornerstone of these rules is to remedy undue discrimination wires that control whether and to whom electricity can transported in interstate commerce. A second critical aspect of the rules is to address recovery of the transition costs of moving from a monopoly regulated regime to one in which all sellers can compete on a fair basis and in which electricity is more competitively priced.

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[1] These rules are the rules on open access and stranded costs in the above dockets (*FERC Statutes and Regulations* ¶ 31,036) and an accompanying rule on Open Access Same-Time Information System and Standards of Conduct (OASIS Final Rule) (*FERC Statutes and Regulations* ¶ 31,037) being issued contemporaneously: The Commission also is issuing contemporaneously a notice of proposed rulemaking on capacity reservation open access transmission tariffs in Docket No. RM96-11-000. *FERC Statutes and Regulations* ¶ 32,517. These final rules and proposed rule are being published concurrently in the *Federal Register*.

In the year since the proposed rules were issued,[2] the pace of competitive changes in the electric utility industry has accelerated. By March of last year, 38 public utilities had filed wholesale open access transmission tariffs with the Commission. Today, prodded by such competitive changes and encouraged by our proposed rules, 106 of the approximately 166 public utilities that own, control, or operate[3] transmission facilities used in interstate commerce have filed some form of wholesale open access tariff. In addition, since the time the proposed rules were issued, numerous state regulatory commissions have adopted or are actively evaluating retail customer choice programs or other utility restructuring alternatives. These events have been spurred by continuing pressures in the marketplace for changes in the way electricity is bought, sold, and transported. Increasingly, customers are demanding the benefits of competition in the growing electricty commodity market.

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[2] On March 29, 1995, the Commission issued two notices of proposed rulemaking concerning open access transmission and stranded cost recovery. Promoting Wholesale Competition Through Open-Access Non-Discriminatory Transmission Service by Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Notice of Proposed Rulemaking and Supplemental Notice of Proposed Rulemaking, 60 FR 17662 (April 7, 1995). *FERC Statutes and Regulations* ¶ 32,514 (1995). On December 13, 1995, the Commission issued a notice of proposed rulemaking on information systems. Real-Time Information Networks and Standards of Conduct. Notice of Proposed Rulemaking, 60 FR 66182 (December 21, 1995), *FERC Statutes and Regulations* ¶ 32,516 (1995).

[3] The Commission's notice of proposed rulemaking in the above dockets proposed to apply the proposed requirements to public utilities that own and/or control facilities used for the transmission of electric energy in interstate commerce. "Own and/or control" is intended to include public utilities that "operate" facilities used for the transmission of electric energy in interstate commerce. However, we have modified the Final Rule regulatory text to remove any ambiguity.

The Commission estimates the potential quantitative benefits from the Final Rule will be approximately $3.8 to $5.4 billion per year of cost savings, in addition to the non-quantifiable benefits that include better use of existing assets and institutions, new market mechanisms, technical innovation, and less rate distortion. The continuing competitive changes in the industry and the prospect of these benefits to customers make it imperative that this Commission take the necessary steps within its jurisdiction to ensure that all wholesale buyers and sellers of electric energy can obtain non-discriminatory transmission access, that the transition to competition is orderly and fair, and that the integrity and reliability of our electricity infrastructure is maintained.

In this Rule, the Commission seeks to remedy both existing and future undue discrimination in the industry and realize the significant customer benefits that will come with open access. Indeed, it is our statutory obligation under sections 205 and 206 of the Federal Power Act (FPA) to remedy undue discrimination.

To do so, we must eliminate the remaining patchwork of closed and open jurisdictional transmission systems and ensure that all these systems, including those that already provide some form of open access, cannot use monopoly power over transmission to unduly discriminate against others. If we do not take this step now, the result will be benefits to some customers at the expense of others. We have learned from our experience in the natural gas area the importance of addressing competitive transition issues early and with as much certainty to market participants as possible.

Accordingly, in this proceeding and in the accompanying proceeding on OASIS the Commission, pursuant to its authorities under sections 205 and 206 of the FPA:

- Requires all public utilities that own, control or operate facilities used for transmitting electric energy in interstate commerce:

  - To file open access non-discriminatory transmission tariffs that contain minimum terms and conditions of non-discriminatory service:

  - To take transmission service (including ancillary services) for their own new wholesale sales and purchases of electric energy under the open access tariffs:

  - To develop and maintain a same time information system that will give existing and potential transmission users the same access to transmission information that the public utility enjoys, and further requires public utilities to separate transmission from generation marketing functions and communications:

- Clarifies Federal/state jurisdiction over transmission in interstate commerce and local distribution and provides for deference to certain state recommendations; and

- Permits public utilities and transmitting utilities to seek recovery of legitimate, prudent and verifiable stranded costs associated with providing open access and FPA section 211 transmission services.

Open Access

The Final Rule requires public utilities to file a single open access tariff that offers both network, load-based service and point-to-point, contract-based service. The Rule contains a pro forma tariff that reflects modifications to the NOPR's proposed terms and conditions and also permits variations for regional practices. All public utilities subject to the Rule, including those that already have tariffs on file, will be required to make section

206 compliance filings to meet the new pro forma tariff non-price minimum terms and conditions of non-discriminatory transmission. Utilities may propose their own rates in a section 205 compliance filing.

The Rule provides that public utilities may seek a waiver of some or all of the requirements of the Final Rule. In addition, non-public utilities may seek a waiver of the tariff reciprocity provisions.

The Final Rule does not generically abrogate existing requirements contracts, but will permit customers and public utilities to seek modification, or termination, of certain existing requirements contracts on a case-by-case basis. As to coordination arrangements and contracts, the Rule finds that these arrangements and contracts may need to be modified to remove unduly discriminatory transmission access and/or pricing provisions. Such arrangements and agreements include power pool agreements, public utility holding company agreements, and certain bilateral coordination agreements. The Rule provides guidance and timelines for modifying unduly discriminatory coordination arrangements and contracts, and specifies when the members of such arrangements must begin to conduct trade with each other using the same open access tariff offered to others. The Rule also provides guidance regarding the formation of independent system operators (ISOs).

The Rule does not require any form of corporate restructuring, but will accommodate voluntary restructuring that is consistent with the Rule's open access and comparability policies.

As discussed in the NOPR, not all owners or controllers of interstate transmission facilities are subject to the Commission's jurisdiction under sections 205 and 206 of the FPA and therefore are not subject to this Rule's open access requirements.

Therefore, the Final Rule retains the proposed reciprocity provision in the pro forma tariff. Without such a provision, non-open access utilities could take advantage of the competitive opportunities of open access, while at the same time offering inferior access, or no access at all, over their own facilities. Thus, open access utilities would be unfairly burdened. We note that some non-jurisdictional utilities have expressed an interest in a mechanism for obtaining a Commission determination that their transmission tariffs satisfy the reciprocity provisions in the pro forma tariffs, and we provide such a mechanism in the Rule.

The Final Rule does not generically provide for market-based generation rates. Although the Rule codifies the Commission's prior decision that there is no generation dominance in new generating capacity, intervenors in cases may raise generation dominance issues related to new capacity. In addition, to obtain market-based rates for existing generation, we will continue to require public utilities to show, on a case-by-case basis, that there is no generation dominance in existing capacity. Further, in all market-based cases, we will continue to look at whether an applicant and its affiliates could erect other barriers to entry and whether there may be problems due to affiliate abuse or reciprocal dealing.

Finally, contemporaneously with this Rule the Commission issues an NOPR on capacity reservations tariffs as an alternative, and perhaps superior, means of remedying undue discrimination.

Transmission/Local Distribution

The Rule clarifies the Commission's interpretation of the Federal /state jurisdictional boundaries over transmission and local distribution. While we reaffirm our conclusion that this Commission has exclusive jurisdiction over the rates, terms, and conditions of unbundled retail transmission in interstate commerce by public utilities, we nevertheless recognize the very legitimate concerns of state regulatory authorities as they contemplate direct retail access or other state restructuring programs. Accordingly, we specify circumstances under which we will give deference to state recommendations. Although jurisdictional boundaries may shift as a result of restructuring programs in wholesale and retail markets, we do not believe this will change fundamental state regulatory authorities, including authority to regulate the vast majority of generation asset costs, the siting of generation and transmission facilities, and decisions regarding retail service territories. We intend to be respectful of state objectives so long as they do not balkanize interstate transmission of power or conflict with our interstate open access policies.

Stranded Costs

With regard to stranded costs, the Final Rule adopts the Commission's supplemental proposal. It will permit utilities to seek extra-contractual recovery of stranded costs associated with a limited set of existing (executed on or be fore July 11, 1994) wholesale requirements contracts and provides that the Commission will be the primary forum for utilities to seek recovery of stranded costs associated with retail-turned-wholesale transmission customers. It also will allow utilities to seek recovery of stranded costs caused by retail wheeling only in circumstances in which the state regulatory authority does not have authority to address retail stranded costs at the time the retail wheeling is required. The Rule retains the revenues lost approach for calculating stranded costs and provides a formula for calculating such costs.

Environmental Issues

The Commission has prepared a Final Environmental Impact Statement (FEIS) evaluating the possible environmental consequences of changes in the bulk power marketplace expected to occur as a result of the open access requirements of this Final Rule. The FEIS focuses, as do most commenters, on possible increases in emissions of nitrogen oxides (NO/X/) from certain fossil-fuel fired generators, which could affect air quality in the producing region and in areas to which these emissions may be carried.

In response to comments on the Draft EIS, the Commission performed numerous additional studies. The FEIS finds that the relative future competitiveness of coal and natural gas generation is the key variable affecting the impact of the Final Rule. If competitive conditions favor natural gas, the Rule is likely to lead to environmental benefits. Both EPA and the Commission staff believe this projected scenario is the more likely one. If competitive conditions favor coal, the Rule may lead to small negative environmental impacts. However, even using the most extreme, unlikely assumptions about the future of the industry, the negative consequences are not likely to occur until after the turn of the century. Because the impacts will remain modest at least until 2010, there is no need for an interim mitigation program. In addition, even if the data showed more significant negative consequences requiring mitigation, the Commission does not have the statutory authority under the Federal Power Act or the expertise to address this possible far-term problem. The Commission believes, however, that there is time for federal and state air quality authorities to address any potential adverse impact as part of a comprehensive NO_X regulatory program under the Clean Air Act.

Despite our conclusions regarding the lack of environmental impacts expected to result from the Rule, the Commission has expected to result from the Rule, the Commission has examined a wide variety of proposals for mitigating possible adverse effects. We share the view of most commenters that the preferred approach for mitigating increased NO/X/ emissions generally is a NO/X/ cap and trading regulatory program comparable to that developed by Congress to address sulfur dioxide emissions in the Clean Air Act Amendments of 1990.[5] The Commission has examined various means of establishing such a program, including use of existing federal authorities under the Clean Air Act, cooperative efforts by state and federal air quality regulators, and development of a new emissions regulatory program administered by the Commission under the Federal Power Act. The Commission has concluded that a NO/X/ regulatory program could best be developed and administered under the Clean Air Act, in cooperation with interested states, and offers to lend Commission support to that effort should it become necessary.

Conclusion

The Commission believes that the Final Rule will remedy undue discrimination in transmission services in interstate commerce and provide an orderly and fair transition to competitive bulk power markets.

II. Public Reporting Burden

The Open Access Final Rule and the Stranded Cost Final Rule specify filing requirements to be followed by public utilities that own, control or operate transmission facilities in interstate commerce in making non-discriminatory open access tariff filings and filings to recover legitimate, prudent and verifiable stranded costs. The information collection requirements of the final rules are attributable to FERC-516 "Electric Rate Filings." The current total annual reporting burden for FERC-516 is 828,300 hours.

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[5] 42 U.S.C.A. § 7651b-e

A. *Docket No. RM95-8-000 (Open Access Final Rule)*

The Open Access Final Rule requires public utilities filing non-discriminatory open access tariffs to provide certain information to the Commission. The Commission estimated that the public reporting burden for the information collection would average 300 hours per response. This estimate included time for reviewing the requirements of the Commission's regulations, searching existing data sources, gathering and maintaining the necessary data, completing and reviewing the collection of information and filing the revised information. No comments on the burden estimate were received. Because the Final Rule adopts essentially the same information requirements that are contained in the proposed rule, we believe that the average filing burden is same for the Final Rule.

In the proposed rule, the Commission noted that there are approximately 328 public utilities, including marketers and wholesale generation entities. We initially estimated that 137 public utilities own, control or operate facilities used for the transmission of electric energy in interstate commerce, and would be subject to the filing requirements of the proposed rule. Upon further review, the Commission believes that approximately 166 public utilities will respond to the information collection. Accordingly, the public reporting burden is estimated to be 49.800 hours.

B. *Docket No. RM94-7-001 (Stranded Cost Final Rule)*

In the supplemental notice of proposed rulemaking, the Commission estimated that the information requirements of the proposed rule would not differ substantially from those contained in the initial proposed rule. In that notice. the Commission estimated that the public reporting burden for the information requirements contained in the proposed rule would be 50 hours per response with 10 responses annually. No comments on this filing burden were received. The information requirements adopted in the Stranded Cost Final Rule are not substantially different from those in the proposed rule. Therefore, the Commission concludes that there will be no additional public filing burden associated with the Stranded Cost Final Rule.

III. Background

In the NOPR, set out a detailed statement of the events leading up to this rulemaking. We repeat that background here, updated to reflect what has happened since March 1995, and discuss why it is necessary to undertake regulatory reform in the electric industry at this time. We do so to provide the necessary

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specifically allow utilities either to follow the terms of the provision or to use alternatives that are reasonable, generally accepted in the region, and consistently adhered to by the transmission provider (e.g.. time deadlines for scheduling changes, time deadlines for determining available capacity). In addition, other tariff provisions require utilities to follow Good Utility Practice, The definition of "Good Utility Practice," contained in Section 1.14 of the Final Rule pro forma tariff, states, that it "is not intended to be limited to the optimum practice. method, or act to the exclusion of all others, but rather to be acceptable practices, methods or acts generally accepted in the region." Thus, where public utilities are permitted to follow regional practices. and elect to do so within 60 -days of the date of publication of the Final Rule in the Federal Register, they should identify the regional practices in their compliance tariff filings.

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4. Future Filings

We recognize that there may be circumstances in which a public utility believes that the Final Rule pro forma tariff does not provide sufficient flexibility or that the utility can propose superior nonrate terms and conditions. Thus, once the compliance tariff and conforming rates go into effect, which will be 60 days after publication of this Rule in the Federal Register, a public utility (either Group 1 or Group 2) may file pursuant to section 205 a tariff with terms and conditions that differ from those set forth in this Rule, provided that it: (1) Serves a copy of its filing on all wholesale customers for whom it has provided transmission service since March 29, 1995 (the date of the Open Access NOPR) and on the state agencies that regulate public utilities in the states where those customers are located; (2) identifies all deviations from its compliance tariff in its letter of transmittal; (3) provides, to the extent practical, a redlined version of the tariff; and (4) demonstrates that such terms and conditions are consistent with, or superior to, those in the compliance tariff. However, it may not seek to litigate fundamental terms and conditions set forth in the Final Rule.[514] In addition, the public utility may file whatever rates it believes are appropriate, consistent with the Transmission Pricing Policy Statement.

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[514] As we stated in our "Further Guidance Order," American Electric Power Service Corp., 71 FERC ¶61,393, 62,539-40, order on rehearing, 72 FERC ¶61,287, order on rehearing, 74 FERC ¶61,013 (1995), all tariffs need not be "cookie-cutter" copies of the Final Rule tariff. Thus, under our new procedure, ultimately a tariff may go beyond the minimum elements in the Final Rule pro forma tariff or may account for regional, local, or system-specific factors. The tariffs that go into effect 60 days after publication of this Rule in the Federal Register will be identical to the Final Rule pro forma tariff; however, public utilities then will be free to file under section 205 to revise the tariffs, and customers will be free to pursue changes under section 206.

5. Waiver

Finally, as noted above, several commenters propose that public utilities that own few transmission facilities be granted waiver, or that application of the Rule to such utilities be deferred until 60 days after they receive a section 211 request. As discussed more fully in Section IV.K.2, we find that it is reasonable to permit certain public utilities for good cause shown to file, within 60 days after this Rule is published in the Federal Register, requests for waiver from some or all of the requirements of this Rule. The filing of a request in good faith for a waiver from the requirement to file an open access tariff will eliminate the requirement that such public utility make a compliance filing unless thereafter ordered by the Commission to do so. It will not, however, exempt such public utility from providing upon request, transmission services consistent with the requirements of the Final Rule.

I. Federal and State Jurisdiction: Transmission/Local Distribution. In the original Stranded Cost NOPR, the Commission clarified that it has exclusive jurisdiction, over unbundled retail transmission in interstate commerce by public utilities: it found that the Commission has exclusive jurisdiction over the rates, terms. and conditions of unbundled retail transmission in interstate commerce by public utilities, up to the point of local distribution. In the Open Access NOPR, the Commission reaffirmed this jurisdictional determination[515] and also addressed the distinction between transmission and local distribution. The Commission stated three reasons for expressing its views on the distinction between Commission-jurisdictional transmission in interstate commerce and state jurisdictional local distribution, in the context of unbundled retail wheeling by public utilities.[516] First, facilities that can be used for wholesale transmission in inter-state commerce by a public utility would be subject to the Commission's open access requirements. Second, states have authority to address retail stranded costs and stranded benefits through their jurisdiction over facilities used in local distribution. Third, as the structure of the industry continues to change dramatically, utilities need to know which regulator has jurisdiction over which facilities and services in order to meet state and federal filing requirements. Accordingly, the NOPR set forth our jurisdictional analysis and several technical factors, for determining what constitutes "facilities used in local distribution."

For unbundled wholesale wheeling, the NOPR proposed to apply a functional test. i.e., whether the entity to whom the power is delivered is a lawful reseller. For unbundled retail wheeling, the NOPR proposed to apply a combination functional technical test that would take into account technical characteristics of the facilities used for the wheeling. The Commission proposed seven indicators of local distribution to be evaluated on a case-by-case basis:

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[515] That determination included the situation in which a former bundled retail customer may need unbundled wheeling services from its previous public utility generation supplier, as well as unbundled wheeling from one or more intervening public utilities, in order to reach a distant generation supplier. In that scenario, the Commission would have jurisdiction over all of the transmission facilities used for the unbundled wheeling provided by the intervening public utilities. The NOPR also noted that the Commission would not have jurisdiction over the rates for the sale of generation by the distant supplier because the transaction would be a retail sale. *FERC Statutes and Regulations* ¶ 32,514 at p. 33,144.

[516] The term "wheeling" is intended to cover any delivery of electric energy from a supplier to a purchaser, i.e., transmission, distribution, and/or local distribution. The Commission also has jurisdiction to order wholesale transmission services in either interstate or intrastate commerce by transmitting utilities that are not also public utilities. *See Tex-La Electric Cooperative of Texas, Inc.*, 67 FERC ¶ 61,019 (1994) reh'g pending.

(1) Local distribution facilities are normally in close proximity to retail customers.

(2) Local distribution facilities are primarily radial in character.

(3) Power flows into local distribution systems; it rarely, if ever, flows out.

(4) When power enters a local distribution system, it is not reconsigned or transported on to some other market.

(5) Power entering a local distribution system is consumed in a comparatively restricted geographical area.

(6) Meters are based at the transmission/local distribution interface to measure flows into the local distribution system.

(7) Local distribution systems will be of reduced voltage. [517]

The NOPR concluded that the application of these tests will enable states to address stranded costs by imposing an exit fee on departing retail customers, or including an adder in the retail customers' local distribution rates.[518]

In the NOPR. the Commission also addressed buy-sell transactions in which an end user arranges for the purchase of generation from a third-party supplier and a public utility transmits that energy in interstate commerce and resells it as part of a "nominal" bundled retail sale to the end user. We explained that the retail sale is actually the functional equivalent of two

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[517] *FERC Statutes and Regulations* ¶ 32,514 at p. 33,145.

[518] Id. at p. 33,144-45.

unbundled sales (one transmission and the other the sale of power) and that we have exclusive jurisdiction over the voluntary sale by public utilities of unbundled transmission at retail in interstate commerce.[519]

Several commenters support the Commission's proposed Jurisdictional demarcation.[520] San Diego G&E states that the Commission correctly proposed to look at both functional factors (such as whether the service is retail or wholesale) and technical factors (such as voltage). PG&E states that the NOPR's functional/technical test is preferable to a bright line voltage test.

Consumers Power states that the Commission has exclusive jurisdiction over all wheeling on an interconnected interstate transmission grid. It suggests that the Commission and the states act through a joint board or hearing to resolve jurisdictional differences and develop a bright line test.

PSE&G and PG&E: express concern that if retail wheeling is implemented, there may be loopholes that would enable customers to evade state jurisdiction and thus avoid paying stranded costs. For example, PSE&G is concerned that a retail customer may request transmission service only and a state commission will be unable to attach a retail stranded cost surcharge to that customer. PG&E proposes, adding another indicator to the functional/technical test— a final tap to a retail customer—to ensure that "high-voltage" retail customers do not evade the state's reach. Moreover, to ensure that retail customers cannot escape state jurisdiction, PG&E recommends that the Commission state, as a matter of policy, that "all retail customers taking retail transmission service from their host utility by definition take service over local distribution facilities."

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[519] As discussed *infra*, there also would be a component of local distribution in such a transaction that would be subject to state jurisdiction.

[520] *E.g.* PG&E, Wisconsin Coalition, Com Ed.

CINergy agrees with the Commission that a distinction between transmission and local distribution is important, but emphasizes the practical need for clarity on a timely basis. To achieve certainty, CINergy proposes that the Commission allow public utilities to file, under section 205, classifications of their facilities as transmission or local distribution. CCEM endorses CINergy's proposal. Although NARUC disagrees that the Commission has jurisdiction over unbundled retail transmission, if the Commission reaffirms the NOPR regarding its jurisdiction, then NARUC supports CINergy's proposal.

PSE&G strongly supports the Commission's proposed case-by-case methodology for determining whether facilities should be classified as transmission or local distribution. SoCal Edison argues that since a utility may have difficulty determining which of its facilities are transmission and which are local distribution, utilities and states should be able to ask the Commission to classify a particular facility. Portland and Orange & Rockland suggest that the Commission provide a forum to resolve disputes over the correct classification of particular facilities.

Ohio Edison states that the Commission should assume jurisdiction over unbundled retail transmission, but only where a state has required this unbundling. It also believes that the Commission should assert jurisdiction over the ancillary services necessary to provide this jurisdictional service.

NYSEG argues that the Commission lacks jurisdiction over the transmission component of bundled retail service. On the other hand. NYSEG argues that the statute, legislative history, and case law reveal that the Commission has jurisdiction over

unbundled retail wheeling from source to load, since it is transmission in interstate commerce. NYSEG argues that the "local distribution" exception to the Commission's jurisdiction applies only to bundled sales of power at retail.

Several state commissions assert that states have rate authority over all facilities used to provide retail service.[521] IL Com argues that states have rate authority over all facilities used to provide retail service, regardless of whether the NOPR would classify these facilities as transmission or local distribution.

MI Com, citing Connecticut Light & Power Company v. Federal Power Commission, 324 U.S. 5 15 (1945) (CL&P), and Arkansas Electric Cooperative v. Arkansas Public Service Commission, 461 U.S. 375, 393-94 (1983), contends that states have plenary jurisdiction over all aspects of retail service, including retail access and unbundled retail transmission service. It asserts that the Commission's effort to expand federal jurisdiction into transmission in connection with retail sales is without statutory justification.

Legal Environmental Assistance argues that the NOPR creates confusion about, and may intrude onto, state jurisdiction. NYMEX argues that when a state orders retail wheeling, the state should have jurisdiction over that transmission-only service.

Oklahoma G&E, citing CL&P and United States v. California Public Utilities Commission, 345 U.S. 295, 316 (1953), asserts that the Commission failed to explain that the term "transmission in interstate commerce" could have different meanings depending on the factual context in which the term is applied. It argues that "transmission in interstate commerce" means the movement, in bulk, of electric energy flowing in interstate commerce, as opposed to the movement of electric energy that has been subdivided for delivery to consumers.

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[521] *E.g.* NM Com, NC Com, AZ Com.

Oklahoma G&E further argues that "[t]he distinction between interconnected operation and radial operation corresponds precisely to this distinction between activities that have potential interstate effects and those that might have interstate effects but are a matter of primarily local concern."[522] Oklahoma G&E also disagrees that the transportation of electric energy sold at wholesale necessarily constitutes transmission in interstate commerce. It argues that the Commission has misapplied case precedent and, by focusing on the level of the associated power sale, the Commission has misunderstood what constitutes a functional distinction between transmission in interstate commerce and local distribution.

NY Com asserts that the grant of jurisdiction to the Commission over wholesale power transactions in interstate commerce under section 201 of the FPA does not reduce the states' authority over local distribution (citing CL&P and Federal Power Commission v. Florida Power & Light Company, 404 U.S. 453, 467 (1972)). NY Cam argues that the NOPR's assertion of exclusive jurisdiction over all facilities used to deliver electricity for resale, even those traditionally regarded as local distribution, violates Congress' assignment of local electric distribution to the states. It takes issue with the Commission's list of factors and says that states and the Commission should agree on a definition that preserves the traditional classification of local distribution facilities. According to NY Com, such definition should focus on the functional characteristics of local electric systems - i.e., electricity flows into a comparatively

restricted geographic area and does not flow back out of that area, and the power is consumed in that area.

NY IOUs argue that the Commission has jurisdiction over unbundled, but not bundled retail wheeling. It says that other factors, including the indicators listed in the NOPR, are irrelevant, and that even long-distance interstate transmission is under state jurisdiction as long as it is bundled with a retail sale. According to NY IOUs, this is the plain meaning of the FPA; resort to legislative history is unnecessary. NY IOUs bases this view on section 201(a), which says that federal regulation extends only to matters not subject to state regulation. NY IOUs says that the only matters subject to state regulation were bundled retail sales, and that since transmission was part of the bundle, Congress intended transmission to stay under state authority as long as it is part of that bundle. It also cites section 201(b), which sets forth exceptions from Commission jurisdiction, and section 201(c), which defines "transmission in interstate commerce" and thus also controls the definition of transmission in intrastate commerce. Finally, NY IOUs argues that the legislative history supports its view, as does the case law.

Central Louisiana believes that the costs of requiring a transmission provider to take unbundled transmission service for both wholesale and retail purposes would far exceed any benefits. In this regard, Central Louisiana says that states clearly have jurisdiction over bundled retail transmission charges and that the proposed approach could not be implemented without states giving up jurisdiction or the passage of new federal legislation.

MN DPS disagrees on legal and policy grounds with the Commission's assertion of jurisdiction over unbundled retail transmission services.[523] It maintains that the Commission's arguments do not negate the language of the FPA specifying that regulation of retail sales of electric energy is reserved to the states. MN DPS argues that the Commission's arguments in support of its position are not on point because the issue is state authority to set rates for retail sales, not inter-state commerce. Further, it declares that jurisdiction over a service does not change simply because it is priced differently.

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[522] Oklahoma G&E Initial Comments at p. 16.

Several commenters argue that unbundled pricing should not expand the Commission's jurisdiction.[524] NARUC argues that the NOPR did not explain why the Commission's authority attaches only to unbundled retail transmission service, why unbundling is jurisdictionally significant, and how transmission of electricity to end users differs from unbundled interstate transmission of natural gas by local distribution companies, which is subject to state regulation. Thus, NARUC, urges the Commission not to claim jurisdiction over unbundled retail transmission services.

NARUC also argues that the Commission's test for distinguishing between transmission and local distribution is not a bright line as discussed in Federal Power Commission v. Southern California Edison Company, 376 U.S. 205 (1964) (Colton). NARUC concludes that when a state determines to enable a retail customer to purchase power from a third-party provider, that state retains the authority to regulate the delivery service provided by the utility.

IL Com asserts that the test should be whether the utility function over which the Commission seeks to exercise

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[523] See also OH Com.

[524] *E.g.*, DOD, NM Com, KY Com. ABATE.

jurisdiction is one which falls within the Attleboro gap.[525] It argues that the Commission has no legal authority to prescribe conditions under which a public utility may provide transmission service within its own service territory to its own retail customers. IL Com concedes that the court cases cited by the Commission can be interpreted to support widely disparate legal and policy positions, but argues that those cases resolved questions of Commission jurisdiction in circumstances where wholesale sales of electric power were being examined and not circumstances where retail sales are being considered. It contends that the question of whether the Commission should exercise jurisdiction over all transmission in retail wheeling has never been addressed before and requires a careful examination of the underlying purposes of Congress in enacting the FPA. IL Com explains that transmission by an Illinois utility of power to a retail consumer within its own service territory is not subject to Commission jurisdiction because that transmission was never within the Attleboro gap and has always been regulated by states.

OK Com recommends that the Commission apply to the electric industry the same policy that it has adopted concerning its regulation of the gas industry and leave unbundled retail service regulation to state authorities.

WI Com argues that if a utility offers unbundled retail access, jurisdiction over transmission services should continue to be based upon the historical demarcation between wholesale and retail transactions. KY Com argues that Congress did not intend, by authorizing wholesale wheeling in the Energy Policy Act, to change the longstanding division of jurisdiction between the Commission and the states. It claims that the NOPR ignores the limitation in the FPA that the Commission has no jurisdiction over retail sales service. NV Com cites several cases noting the states' historical authority to regulate retail rates.

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[525] *See Public Utilities Commission v. Attleboro Steam & Electric Company*, 273 U.S. 83 (1927).

IA Com proposes a definition of local distribution and transmission that would preserve the jurisdictional status quo and does not put a state commission in the position of losing authority over certain elements of a retail transaction should it allow retail wheeling. IA Com's proposed definition is as follows:

> Distribution - Service provided by a utility directly connected to an ultimate consumer of electricity is a distribution service with respect to electric energy delivered to that consumer.
>
> Transmission - Service provided by a utility with respect to electric energy to be delivered to an ultimate consumer through another utility is a transmission service.[526]

Montana Power states that a reasonable way to give effect to the "local distribution" exemption is to define "local distribution" as a bundled retail sale, even if interstate facilities are used.

Several commenters criticized the NOPR's functional/physical indicators. PA Com disagrees with the Commission's discussion of the FPA's legislative history and asserts that the FPA does not address the issue of what constitutes local distribution. PA Com contends that the issue was resolved by the Supreme Court in CL&P in a manner contrary to the Commission's technical-functional test and that the NOPR minimized CL&P. NM Com asserts that the proposed engineering and functional elements for determining the status of local distribution facilities fail to account for the governmental or legalistic test requirement of the FPA as identified in CL&P.

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[526] IA Com Initial Comments at p. 4.

KY Com concludes that a physical definition of distribution facilities. based on objective criteria, is consistent with the FPA and is necessary to provide a clean line of demarcation.

CO Com argues that Congress used a transactional test rather than a functional test and that Congress intended all retail transactions to be under state jurisdiction. According to CO Com, there is concurrent jurisdiction over unbundled transmission in interstate commerce to an end-user. Moreover, CO Com asserts that unbundled intrastate transmission to a wholesale purchaser is under state jurisdiction (citing section 201(b)(l)). Finally, CO Com argues that the state has authority over unbundled transmission in intrastate commerce to an end-user when the transmission-providing utility, end-user, and generator are all within the same state.

Other commenters prefer a functional test. Natural Resources Defense, DOE, and Sustainable Energy Policy generally agree that a line needs to be drawn between transmission and local distribution but believe that the Commission's test is unnecessarily cumbersome or may lead to legal uncertainty, at least within the context of stranded benefits. Instead, Natural Resources Defense proposes the following functional test, which is based on end-use service:

> The Federal Power Act does not affect state regulators' jurisdiction to apply distribution charges - either volume-based or fixed - to electricity that is used by any utility customer to provide end-use services (as distinguished from electricity that

is purchased for resale to end-use customers).[527] Sustainable Energy Policy endorses Natural Resources Defense's position. DOE suggests that a functional definition of local distribution (i.e., electricity provided for end-use service) may be the best way to avoid legal uncertainty.

EPA argues that the Commission's proposed physical definition may encourage gaming to avoid stranded costs and costs associated with public policy goals such as energy efficiency, renewable energy development costs and R&D funding, and a physical definition assumes that power flows into, and not out of, distribution systems, which would not allow for distributed generation (e.g.. fuel cells). Thus. EPA urges the Commission to adopt a functional definition that "local distribution occurs whenever electricity is provided by a utility for end-use service." Alternatively. EPA suggests that the Commission add a provision to its approach that "the provision of electricity for end-use service generally involves local distribution." Sustainable Energy Policy suggests a nonbypassable charge levied on all users of the distribution system. It endorses the policy formulation set forth by Natural Resources Defense in its initial comments. Reynolds wants to ensure that there is always at least concurrent state jurisdiction over lines used to serve enduse customers, since only states can order retail wheeling.

Detroit Edison argues that state/federal jurisdictional issues should be resolved by focusing on the use of the facilities. It says that facilities that are used to distribute a utility's own power to its own local customers should be subject to state regulation, while the use of facilities for wholesale power transactions or wholesale or retail transmission in interstate commerce should be under federal regulation.

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[527] Natural Resources Defense Initial Comments at p.3.

Mountain State Petroleum Assoc. argues that the Commission should use a functional test based on state boundaries: if a line is in more than one state. there is Commission jurisdiction; if a line is entirely within one state. there is state jurisdiction.

MD Com states that it believes that the Commission's proposed indicators for determining where to draw the line are adequate, but adds that it does not concede the Commission's assertion of jurisdiction over unbundled retail transmission.

Some commenters suggest that implementation of the NOPR's tests could have adverse consequences. NH Com objects to the NOPR's specific tests; for example, if the Commission asserts jurisdiction over facilities because they are not radial. New Hampshire's policy of encouraging looping rather than radial lines would have the ironic effect of destroying state jurisdiction. NJ BPU states that there may be situations when the NOPR factors would not produce the proper result. It requests that the final rule recognize the need for case-by-case flexibility in determining where federal jurisdiction ends, so that the Commission and the states can work cooperatively.

NRRI argues that the NOPR's test could make siting of new transmission lines more difficult because states have in the past required native load customers to pay that part of the transmission-related revenue requirement that is not covered by unbundled transmission service. NRRI contends that, if the Commission asserts jurisdiction over all unbundled transmission service and if there is a firm point-to-point service capacity right that has value and is reassignable, then state commissions might eliminate portions of the transmission systems subject to capacity rights from rate base. NRRI is also concerned that the NOPR's transmission/local distribution test could create a price squeeze between bundled and unbundled retail transmission rates.

IN Com argues that the NOPR's view of jurisdiction would discourage retail wheeling. It says that states will be reluctant to order wheeling if the result is that they lose jurisdiction over the previously rolled-in transmission aspect of the service. It suggests that the Commission use negotiated rulemaking to address jurisdictional issues.

Several commenters suggest alternative approaches to jurisdictional line-drawing. NV Com suggests that the Commission consider federal and state jurisdiction over transmission by using "network" and "non-network" concepts:

> The "network" concept for regulation recognizes that there is an interstate network of electric facilities used to link generation with loads. The operation of that network is indifferent to whether the electrical flows are retail or wholesale flows. Conceptually, events on the network could fall under federal jurisdiction. Where facilities provide essential service for the delivery of power, but do not substantially affect the electrical flows on the network, the facilities fall outside the network and would remain within the traditional domain of the state commission. As a consequence the delineation of federal and state jurisdiction evolves from the recognition of the events and where they occur as opposed to a rigid consideration of the physical properties of the facilities involved.[528]

NV Com further explains that the determination of what is a network event would require a case-by-case examination.

OH Com asserts that Congress intends there to be a bright line between state and federal jurisdiction and that the Commission has failed to provide such a bright line. OH Com proposes the use of retail marketing areas to provide the bright line—the

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[528] NV Com Reply Comments at p. 3

jurisdictional line would be at the point at which power enters the retail marketing area of the entity delivering the power to the retail customer. OH Com cites section 212(g) Of the FPA, as amended by the Energy Policy Act, which provides that the Commission cannot issue any order under the FPA inconsistant with state law governing retail marketing areas.

Under OH Com's proposal, the Commission would have jurisdiction over the wheeling-out and wheeling-through components of retail wheeling and the state would have jurisdiction over the wheeling-in component due to its local nature. OH Com concludes that the Commission's approach "fails to-meet the legal standard FERC must consider, and is inconsistent with the 'savings clause' and legitimacy of 'retail marketing areas' as discussed in the amended FPA."[529] OH Com also explains that the Commission's approach "is wreaking havoc on the state's ability to develop an interruptible buy-through arrangement to provide an increased competitive option for its retail customers."[530] OH Com further encourages the use of mutual deference to promote Congress intent in mandating a system of federal/ state cooperation. In support, OH

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[529] Sections 212(g) and 212(h) of the FPA.

[530] We note that since OH Com filed its comments, it approved an interruptible buy-through plan, *See Interruptible Electric Service Guidelines*, Case No. 95-866-EL-UNC,—PUR 4th—(Ohio PUC Feb. 15, 1996). *See also Central Illinois Light Company*, Docket No. ER96-1075-000 (1996) (accepting amendment to open access transmission tariffs that expands service eligibility to accommodate participation in experimental retail wheeling pilot program approved by the Illinois Commerce Commission): *Illinois Power Company*, Docket No. ER96-1285-000, 75 FERC (1996): *cf. Illinois Power Company*,—PUR4th—, NO. 95-0494 (Illinois Commerce Commission Mar. 13, 1996) (offering retail direct access service providing transmission and ancillary services using the rates, terms, and conditions of Illinois Power's open access tariff on file with the Commission); recently introduced legislation in Rhode Island, H.B. 8124, the Utility Restructuring Act of 1996.

Com cites federal and state enforcement of telecommunications laws. NRRI also suggests that the jurisdictional line be drawn at the retail marketing area.

DC Com argues that the NOPR test is too difficult to administer and will create problems in determining the rate base at the state level. It suggests that the Commission should have jurisdiction over transmission from the source to the boundary of the "home" utility that delivers the power to the customer, with state jurisdiction over all aspects of the transmission service within that utility's franchise territory. AZ Com also expresses doubts that the NOPR's test is workable.

Several commenters propose that the Commission and state authorities address the jurisdictional issue jointly. SBA characterizes the Commission's proposed demarcation line as "laudable but misguided."[531] SBA recommends that a federal/state board be established to resolve the transmission/local distribution dilemma, similar to what Congress did for allocating costs between interstate and intrastate communications. SBA explains that the problem in the communications industry was the impossibility of allocating a portion of a single copper wire to interstate or intrastate service.

AZ Com notes that even if the Commission is correct, the FPA clearly does not preempt a state from concluding that retail transmission or other direct access programs should be implemented in that state. AZ Com suggests that there may be concurrent jurisdiction and that mutually agreed-upon principles should be implemented to determine which jurisdiction should be given deference.

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[531] SBA Initial Comments at p. 36.

MD Com states that in determining tht status of particular facilities, the Commission should give substantial weight to determinations made by states. ABATE states that the Commission could initially defer to states with respect to the determination of rates, terms, and conditions, while maintaining the right to review and overturn the state determination.

If the Commission maintains its position concerning jurisdiction. NARUC argues that the Commission should not implement its multi-factor test, but should enter into discussions with state commissions to develop workable alternatives. NH Com argues that pricing the retail part of a transaction, even if it involves use of the transmission system, should be subject only to state jurisdiction. NH Com wants to create a mechanism by which state and federal regulators combine their efforts in cooperative regulation; it suggests several alternatives such as state/federal agreements for shared jurisdiction.

KY Com and NRRI object to the statement in the NOPR that retail buy-through service is really transmission service (subject to the Commission's jurisdiction) plus a sale of generation at retail (subject to state jurisdiction). From a policy standpoint, KY Com argues that the Commission's approach creates a powerful disincentive for a state to embark on changes that otherwise might foster a more competitive environment. NRRI argues that the Commission's approach may violate sections 212(g) and 212(h).

IL Com is concerned that industrial customers who get direct access may attempt to evade state, jurisdiction, and thus avoid retail stranded cost charges, by bypassing facilities, such as radial lines. It contends that retail wheeling rate surcharges would be a more effective means of recovering retail stranded costs if states were allowed to apply them to unbundled transmission and local distribution rates, not just the local distribution component of such rates.

NC Com asserts that "(a) significant cottage industry may well arise solely to convert retail customers. into wholesale customers, thereby subverting the intent of Congress as expressly set forth in EPACT."[532] If the Commission does not adopt NARUC's proposal, NARUC asserts that the Commission's functional test should not permit an end user to bypass the distribution service provided by the utility. It urges the Commission to assure that there will be some facility involved in the transaction that will be defined as providing a local distribution service.

NARUC also requests that the following sentence be added to proposed 18 CFR 35.27:

> Nothing in this part limits the authority of a State commission in accordance with State law (1) to allow or disallow the inclusion of the costs of electric energy purchased at wholesale in retail rates subject to such State commission's jurisdiction, (2) to establish competitive procedures for the acquisition of such electric energy, or (3) to establish nondiscriminatory fees for the delivery of such electric energy to retail consumers for purposes established in accordance with State law.(533)

Duke is concerned about the potential for regulatory gaps, which could lead to costs not being recovered from either federal or state jurisdiction. Duke is also concerned that where facilities are used for both wholesale and retail transactions, costs might not be recovered if federal and state regulators use different methods of cost allocation.

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[532] NC Com Initial Comments at p.7.

[533] NARUC Reply Comments at p. 15-16.

In response to the NOPR's proposal for functional unbundling,[534] CA Com agrees that it is important to draw a distinction between transmission and local distribution and that a bright line is not possible, but suggests that corporate or functional unbundling might provide a means to establish a workable bright line without relying on the more qualitative approach proposed in the NOPR. Arizona argues that rather than unbundling transmission for retail purposes, each utility should establish a distribution function that would obtain transmission on behalf of retail customers, taking service under the utility's tariff. Arizona states that this would simplify the allocation of transmission costs, since all transmission costs would be under the Commission's jurisdiction. Arizona argues that the Commission should permit the utility to recover the distribution rate approved by the state. According to Arizona, this would create a bright line between state and federal jurisdiction.

TX Com argues that the proposed text would not be applicable to intrastate utilities in Texas because they do not operate in interstate commerce. Thus, it asserts that it should continue to regulate Electric Reliability Council of Texas (ERCOT) transmission and distribution service and deal with stranded cost issues that arise in connection with any retail wheeling initiatives.

Several commenters object to the Commission's proposal to assert jurisdiction over transactions that are buy-sell transactions in name only.[535] AEP argues that the Commission should avoid an unnecessary conflict over state/federal jurisdiction, that may be caused by the NOPR's statement that buy-sell transactions are in fact transmission subject to Commission Jurisdiction. It suggests that the Commission attempt to reach agreement with the states on this matter or ask Congress for any necessary statutory change. Citizens Utilities also argues that the Commission should not unbundle the interstate transmission aspect of buy-sell transactions. It says that, unlike the analagous gas contracts, buy-sell arrangements on the electric side are not an end run around clear federal jurisdiction. Further, it argues that it would be very difficult to define those buy-sell transactions that truly belong under federal jurisdiction.

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[534] *FERC Statutes and Regulations* ¶ 32,514 at p. 33,080-83.

[535] See id. at p. 33,082

IL Com also objects to the NOPR's characterization of buy-sell transactions. It argues that the fact that a transaction becomes unbundled does not suddenly make part of it under federal jurisdiction. Nucor argues that there is no need for the Commission to resolve this issue now; it suggests that the buy-sell arrangement is only tangentially related to open access. It argues that each buy-sell transaction will have to be addressed individually.

UT Com seeks clarification as to what the Commission means by buy-sell arrangements:

> we currently authorize interruptible "buy-through" contracts, through which a retail customer, taking service subject to interruption for either economic or technical reasons, can opt to "buy-through" an interruption. The public utility purchases energy on behalf of the customer and sells it at cost to the customer. In our opinion, such transactions are not an example of a buy-sell transaction within the meaning of the proposed rule.[536]

DOD objects to the statement in the NOPR that "buy-sell" transactions are not really bundled retail service. It says that this

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[536] UT Com Initial Comments at p. 4-5.

view will discourage the development of innovative state progmms, such as direct access programs. NYSEG also argues that buy-sell transactions are not under the Commission's jurisdiction. It argues that these transactions are unlike buy-sell transactions on the gas side, where the Commission asserted jurisdiction to prevent LDCs from circumventing the nondiscrimination standard it imposed on the release of capacity. NYSEG says:

> In contrast to its regulation of gas buysells. if the Commission regulates electric buy-sell transactions it would forego regulation of a transaction in which the Commission has a significant interest (i.e., access to the upstream seller's transmission), to regulate a transaction in which the Commission has virtually no interest (i.e.. access to the distributing utility's system). Electric utilities must serve each retail customer irrespective of whether the customer takes traditional bundled service or retail buy–sell service. Unlike excess upstream gas pipeline capacity, the capacity on the local utility's electric system would not be allocated to another customer in a FERC jurisdictional transaction absent the electric buy-sell transaction. Electric buy-sell transactions are not designed so as to manipulate the assignment of upstream transmission capacity. Consequently, the impetus for FERC to reclassify gas buy-sell transactions as capacity assignments is not present in the electric context.[537]

NYSEG argues that there are only two possible grounds for the Commission's assertion of jurisdiction over electric buy-sell transactions: either (1) the sale for resale by the supplier is really a sale at retail to the end user, and the resale by the local utility is really unbundled retail wheeling); or (2) the Commission has jurisdiction over transmission service that is part of bundled retail service. It claims that the second ground is invalid because the transmission aspect of bundled retail service is distribution. It also claims that the first ground is invalid because it assumes that the sale by the supplier to the local utility is not a sale for resale even though the contract says that it is. NYSEG states:

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[537] NYSEG Initial comments at p. 48 (footnote omitted).

> The logical outcome would be that FERC would not have jurisdiction over the sale by the supplier to the utility, including transmission by that supplier because it would be a bundled retail sale. This is because, if the commission holds the resale to be a retail wheel, then it would have to find that the sale by the supplier is a retail sale to the end user. The Commission cannot at once regulate the sale for resale and the "retail transmission service." The Commission would regulate the transmission rates of the local franchise utility, although it would not regulate the access to such transmission service—a matter FERC leaves to state regulators. In the process, FERC would abandon the ability to regulate access to the supplier's bundled "retail power sale and transmission service," a transaction that FERC arguably has an interest in regulating.[538]

Finally, NYSEG argues that if the Commission insists on asserting jurisdiction, it should at least grandfather existing contracts.

UT industrials state that where there is a state barrier to a buy-sell transaction, the Commission should allow the utility to file a tariff with the Commission that would permit the utility to complete a voluntary buy-sell transaction as the NOPR proposes. However, it contends that when a state regulatory authority is authorized to, and has approved buy-sell transactions, it is not necessary for the Commission to become involved. It urges the Commission to allow such transactions to take place free of Commission regulation. Commission Conclusion.

In the discussion below, the Commission addresses the following jurisdictional issues raised in the prior NOPRs:

a. Does the Commission have jurisdiction over unbundled transmission in interstate commerce by a public utility when such transmission is used to transport electric energy that is sold to an end user?

b. If so, what facilities are jurisdictional to the Commission in a situation involving the unbundled delivery in interstate commerce by a public utility of electric energy from a third-party supplier to an end user?

c. What facilities are jurisdictional to the Commission in a situation involving the unbundled delivery in interstate commerce by a public utility of electric energy from a third-party supplier to a purchaser who will then re-sell the energy to an end user?

d. What procedures are appropriate for making jurisdictional determinations?

In addition, the Commission addresses concerns raised by state regulators which indicate that competition and open access are perceived as threatening the traditional regulatory functions of state commissions. The Federal Power Act differentiates between state and federal regulation of electric power. As we discuss below, the Commission believes that any change in state or federal jurisdiction over physical transmission assets and related costs will not affect the traditional tasks of state and federal regulators.

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[538] NYSEG Initial Comments at p. 50.

The wide range of jurisdictional interpretations and proposals in the comments reflects the fact that the legislative history of the FPA and case law interpreting federal/state jurisdiction under that Act and the Natural Gas Act grew out of a market structure in which electricity and transmission generally were bought and sold on a bundled basis. As a result, most transactions included either a retail or wholesale sale of electric energy and jurisdictional lines were drawn on the basis of this sale. Thus, the cases simply do not resolve dispositively these jurisdictional issues when they arise in the context of the market structures and unbundled transactions being contemplated in today's electric industry. However, after reviewing the extensive analysis of the FPA, legislative history, and case law contained in both our initial Stranded Cost NOPR and in our Open Access NOPR, and the comments received on that analysis, we continue to believe that we were correct in asserting jurisdiction over the transmission component of an unbundled interstate retail wheeling transaction. We therefore reaffirm our conclusion. We also reaffirm and clarify our determinations regarding the tests to be used to determine what constitute Commission-jurisdictional transmission facilities and what constitute state-jurisdictional local distribution facilities in situations involving unbundled wholesale wheeling and unbundled retail wheeling.[539]

At the same time, the" Commission strongly supports the efforts of states to pursue pro-competitive policies. We recognize that jurisdictional issues raise overlapping Federal and state policy concerns that call for heightened cooperation among federal and state regulators. As discussed below, where states unbundle retail sales, we will give deference to their determinations as to which facilities are transmission and which are local distribution, provided that the states, in making such determinations, apply the seven criteria discussed in the NOPR and reaffirmed below. In addition, we clarify our view that there is an element of local distribution service in any unbundled retail transaction, and further clarify other aspects of our jurisdictional ruling to preserve state jurisdiction over matters that are of local concern and will remain subject to state jurisdiction if retail unbundling occurs.

We first address our legal determination that if unbundled retail transmission in interstate commerce occurs voluntarily by a public utility or as a result of a state retail access program, this Commission has exclusive jurisdiction over the rates, terms, and conditions of such transmission. No commenter has raised cases or legislative history not previously considered in our prior NOPRs, and we will not repeat here our full legal analysis of this issue.[540] However, we find compelling the fact that section 201 of the FPA, on. its face, gives the Commission jurisdiction over transmission in interstate commerce (by public utilities) without qualification.[541] Unlike our jurisdiction over sales of electric energy, which section 201 of the FPA specifically limits to sales at wholesale, the statute does not limit our transmission jurisdiction over public utilities to wholesale transmission.

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[539] Not only do we conclude that our determinations are legally supportable under the case law, but we believe it is imperative to provide guidance to public utilities and state regulators as to our position on where the jurisdictional boundaries lie.

[540] The Commission's complete legal analysis on this issue, and on the related issue of what facilities are Commission-jurisdictional transmission facilities, and what are state jurisdictional local distribution facilities, are contained in Appendix G to this Rule.

[541] Section 201(b)(1) specifically exempts from Commission jurisdiction facilities used for transmission in intrastate commerce and transmission of electric energy consumed wholly by the transmitter. As a result, we have no jurisdiction over retail wheeling that occurs in Alaska, Hawaii and the Electric Reliability Council (ERCOT) portion of Texas since transactions in those areas are intrastate.

In response to those commenters (including NARUC) who argue that the Commission did not explain why its authority attaches only to unbundled, but not bundled, retail transmission in interstate commerce by public utilities, we believe that when transmission is sold at retail as part and parcel of the delivered product called electric energy, the transaction is a sale of electric energy at retail. Under the FPA, the Commission's jurisdiction over sales of electric energy extends only to wholesale sales. However, when a retail transaction is broken into two products that are sold separately (perhaps by two different suppliers: an electric energy supplier and a transmission supplier), we believe the jurisdictional lines change. In this situation, the state clearly retains jurisdiction over the sale of the power. However, the unbundled transmission service involves only the provision of "transmission in interstate commerce" which, under the FPA, is exclusively within the jurisdiction of the Commission. Therefore, when a bundled retail sale is unbundled and becomes separate transmission and power sales transactions, the resulting transmission transaction falls within the Federal sphere of regulation.

In asserting jurisdiction over unbundled retail transmission in interstate commerce by public utilities, the Commission in no way is asserting jurisdiction to order retail transmission directly to an ultimate consumer. Section 212(h) of the FPA clearly prohibits us from doing so. In addition, as stated in both the initial Stranded Cost NOPR and the Open Access NOPR, we do not address whether states have authority to order retail wheeling in interstate commerce. The Commission's assertion of jurisdiction is that if retail transmission in interstate commerce by a public utility occurs voluntarily or as a result of a state retail wheeling program, the Commission has exclusive jurisdiction over the rates, terms, and conditions of such transmission and public utilities offering such transmission must comply with the FPA by filing proposed rate schedules under section 205.

The Commission clarifies that nothing in this jurisdictional determination changes historical state franchise areas or interferes with state laws governing retail marketing areas of electric utilities: Section 212(g) of the FPA prohibits Commission orders that would be inconsistent with such laws. However, we reject arguments made by some of the commenters that section 212(g) could somehow be construed to give states authority over the rates, terms, and conditions of unbundled interstate transmission within retail marketing areas.[542] While our jurisdiction cannot affect whether and to whom a retail electric service territory (marketing area) is to be granted by the state, and whether such grant is exclusive or nonexclusive, neither can state jurisdiction affect this Commission's exclusive jurisdiction over transmission in interstate commerce by public utilities.

In response to several of the commenters, we further clarify that the Commission's jurisdiction over the rates, terms, and conditions of unbundled retail transmission is no broader than our authority over transmission used for wholesale transactions; and will not affect matters otherwise left to the states by

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[542] The legislative history of FPA section 212(g) and its predecessor, former section 211(c)(3), indicates that the provision was focused on not interfering with state laws governing retail service territories and not permitting Commission wheeling orders "for purposes of sale by a utility to an ultimate consumer who is within the service territory of another utility (other than the applicant) where such territory is established by or under State law, rule, or decision," See H.R. Conf. Rep. No. 1750, 95th Cong., 2d Sess. 92 (1978), reprinted in 1978 U.S. Code Cong. & Ad. News 7797, 7826. Nothing on the face of section 212(g) or the legislative history of either the Energy Policy Act or PURPA indicates that the provision in any way affects the Commission's authority over rates, terms, and conditions of transmission in interstate commerce by public utilities.

Congress.[543] The Federal Power Act recognizes that retail marketing areas are governed by state law. Moreover, we believe that states have authority over the service of delivering electric energy to end users. In exercising this authority, state regulatory commissions and state legislatures have traditionally developed social and environmental programs suited to the circumstances of their states. State regulation of most power production and virtually all distribution and consumption of electric energy is clearly distinguishable from this Commission's responsibility to ensure open and non-discriminatory interstate transmission service. Nothing adopted by the Commission today, including its interpretation of its authority over retail transmission or how the separate distribution and transmission functions and assets are discerned when retail service is unbundled, is inconsistent with traditional state regulatory authority in this area.

The Commission reiterates its strong interest in preventing any balkanization of the interstate power market. Although the Commission believes its Final Rule will accommodate retail competition, if it is offered voluntarily by a utility or ordered by a state, our policies relate only to the bulk power market and not traditional state regulation of the retail market.[544]

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[543] Among other things, Congress left to the States authority to regulate generation and transmission siting. See FPA sections 201(b) and 211(d)(1); Section 731 of the Energy Policy Act.

[544] This Final Rule will not affect or encroach upon state authority in such traditional areas as the authority over local service issues, including reliability of local service; administration of integrated resource planning and utility buy-side and demand-side decisions, including DSM; authority over utility generation and resource portfolios; and authority to impose non-bypassable distribution or retail stranded cost charges.

NARUC has requested that the Commission specifically clarify in §35.27 of its proposed rules[545] that nothing in our final rule limits the authority of a state commission "to allow or disallow the inclusion of the costs of electric energy purchased at wholesale in retail rates subject to such State commission jurisdiction." We will adopt NARUC's proposal with modification, but add it as a separate subsection. The Final Rule adopts a new § 35.27(b) as follows:

> Nothing in this part (i) shall be construed as preempting or affecting any jurisdiction a state commission or other state authority may have under applicable state and federal law, or (ii) limits the authority of a state commission in accordance with state and federal law to establish (a) competitive procedures for the acquisition of electric energy, including demand-side management, purchased at wholesale, or (b) non-discriminatory fees for the distribution of such electric energy to retail consumers for purposes established in accordance with state law.

With respect to the Commission's adoption of the Open Access NOPR's functional/technical tests for determining what facilities are Commission-jurisdictional facilities used for transmission in interstate commerce and what facilities are state-jurisdictional local distribution facilities, the case law supports a bright line for unbundled wholesale transmission, i.e., transmission of electric energy that is being sold for resale. This is consistent with the bright line drawn by Congress to fill the Attleboro gap for regulating wholesale sales of electric energy. The case law also supports a bright line with respect to retail transmission by intervening utilities. i.e., transmission by those utilities between the new retail generation supplier and the public utility that previously provided bundled retail service to the end user. However, despite many commenters' arguments to the contrary, we cannot define such a bright line for unbundled retail transmission by the public utility that previously provided bundled retail service to the end user. In fact, the limited case law, including CL&P and Colton, supports a case-by-case determination.[546] Accordingly, we believe our technical test, with its seven indicators, will permit reasoned factual determinations in individual cases.

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[545] Section 35.17 of the proposed rules provided that any public utility seeking authorization to engage in sales for resale at market-based rates shall not be required to demonstrate any lack of market power in generation with respect to sales from capacity first placed in service on or after 30 days from the date of publication of the Final Rule in the Federal Register. *FERC Statutes and Regulations*, ¶32,514 at p. 33,154.

Although we are unable to draw the bright line for local distribution facilities that many commenters would like, we believe it is important to make two clarifications regarding local distribution in the context of retail wheeling. First, even when our technical test for local distribution facilities identifies no local distribution facilities for a specific transaction, we believe that states have authority over the service of delivering electric energy to end users. Second, through their jurisdiction over retail delivery services, states have authority not only to assess stranded costs but also to assess charges for stranded benefits, such as low-income assistance and demand-side management. Because their authority is over services, not just the facilities, states can assign stranded costs and benefits based on usage (kWh), demand (kW), or any combination or method they find appropriate. They do not have to assign them to specific facilities.[547]

Thus, while we believe in most cases there will be identifiable local distribution facilities subject to state jurisdiction, we also believe that even where there are no identifiable local distribution facilities. states nevertheless have jurisdiction in all circumstances over the service of delivering energy to end users. Under this interpretation of state/federal jurisdiction, customers have no incentive to structure a purchase so as to avoid using identifiable local distribution facilities in order to bypass state jurisdiction and thus avoid being assessed charges for stranded costs and benefits.

Based on concerns raised by state commissions as well as some utilities, we have further determined that it is appropriate to provide deference to state commission recommendations regarding certain transmission/local distribution matters that arise when retail wheeling occurs. We also believe it is important to develop mechanisms to avoid regulatory conflict and to help provide certainty to utilities as to which regulator has jurisdiction over which facilities. These are discussed below.

Determining where to draw the jurisdictional line for facilities used in unbundled retail wheeling transactions will involve case-specific determinations that evaluate the seven local distribution indicators that we are adopting. We believe that the Commission should take advantage of state regulatory authorities' knowledge and expertise concerning the facilities of the utilities that they regulate. Therefore, in instances of unbundled retail wheeling that occurs as a result of a state retail access program, we will defer to recommendations by state regulatory authorities concerning where to draw the jurisdictional line under the Commission's technical test for local distribution facilities, and how to allocate costs for such facilities to be included in rates, provided that such recommendations are consistent with the essential elements of the Final Rule.[548] Moreover, we recognize that in some cases the Commission's seven technical factors may not be fully dispositive and that states may find other technical factors that may be relevant. We will consider jurisdictional recommendations by states that take into account other technical factors that the state believes are appropriate in light of historical uses of particular facilities.

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[546] As noted, the Commission's detailed legal analysis is contained in Appendix G. We are particularly persuaded by the Supreme Court's statement that whether facilities are used in local distribution is a question of fact to be decided by the Commission as an original matter. See CL&P, 515 U.S. at p. 534-35.

[547] As noted above, states retain authority over state integrated resource planning, utility resource portfolios, and utility buy-side and demand-side decisions.

Some commenters have asked the Commission to provide a forum to prevent or resolve disputes over the correct classification of facilities as transmission or local distribution. As a means of facilitating jurisdictional line-drawing, we will entertain proposals by public utilities, filed under section 205 of the FPA, containing classifications and/or cost allocations for transmission and local distribution facilities. However, as a prerequisite to filing transmission/local distribution facility classifications and/or cost allocations with the Commission, utilities must consult with their state regulatory authorities. If the utility's classifications and/or cost allocations are supported by the state regulatory authorities and are consistent with the principles established in the Final Rule, the Commission will defer to such classifications and/or cost allocations.[549] We

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[548] In order to give such deference, we expect state regulators to specifically evaluate the seven indicators and any other relevant facts and to make recommendations consistent with the essential elements of the Rule.

[549] This should also alleviate some concerns about the potential for costs not being accounted for if the Commission and a state commission use different methods of allocating costs.

encourage public utilities and their state regulatory authorities to attempt to agree to utility-specific classifications and allocations that the utility may file at the Commission.

A number of commenters have asked the Commission to defer to state commission recommendations or decisions regarding rates, terms, and conditions of unbundled retail transmission in interstate commerce by public utilities. Some have suggested that we set broad guidelines for such rates, terms, and conditions, and then allow states to actually implement the guidelines. While the Commission cannot simply turn over its jurisdiction for the states to implement, we understand the concerns raised by many state regulators and believe that deference to state commissions with regard to rates, terms, and conditions may be appropriate in some circumstances. as discussed below.

As we determined in the NOPR, when unbundled retail wheeling in interstate commerce occurs, the transaction has two components for jurisdictional purposes—a transmission component and a local distribution component. The Commission has jurisdiction over facilities used for the transmission component of the transaction, and the state has jurisdiction over facilities used for the local distribution component.[550] Thus, the rates, terms, and conditions of unbundled retail transmission by a public utility must be filed at the Commission. When this occurs, we will generally expect unbundled retail wheeling customers to take service under the same FERC tariff that applies to wholesale customers. However, if the unbundled retail wheeling occurs as part of a state retail access program, it may be appropriate to have a separate retail transmission tariff[551] to accommodate the design and special needs of such programs. In such situations, the Commission will defer to state requests for variations from the FERC wholesale tariff to meet these local concerns, so long as the separate retail tariff is consistent with the Commission's open access policies and comparability principles reflected in the tariff prescribed by this Final Rule. In addition, rates must be consistent with our Transmission Pricing Policy Statement. and the guidance herein concerning ancillary services.[552]

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[550] As discussed above, even if there were instances where no local distribution facilities are used, we believe states have authority over the service of delivering electric energy to end users.

A final jurisdictional issue raised in the Open Access NOPR concerns buy-sell transactions. We remain concerned, just as we were with buy-sell arrangements in the gas industry, that buy-sell arrangements can be used by parties to obfuscate the true transactions taking place and thereby allow parties to circumvent Commission regulation of transmission in interstate commerce. Thus, we reaffirm our conclusion that we have jurisdiction over the interstate transmission component of transactions in which an end user arranges for the purchase of generation from a third-party. However, we recognize that there is a wide range of programs and transactions that might or might not fall within this category. We will address these on a case-by-case basis.

In summary, the Commission reaffirms and clarifies its prior jurisdictional conclusions and tests for determining the demarcation between federal and state jurisdiction over transmission in interstate commerce and local distribution. We

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[551] *I.e.*, the tariff would be different from the tariff that applies to wholesale customers. Such tariff would still be filed with the Commission under FPA section 205.

[552] In applying the principles of the Final Rule to retail transmission tariffs, the Commission clearly cannot order retail wheeling directly to an ultimate consumer. See FPA section 212(h).

have attempted to address these issues in a way that provides for flexibility and recognition of legitimate state concerns. With regard to retail services, we recognize the states' concerns that the unbundling of retail transactions would result in changes from what historically has been regulated by the states (principally, the rates of transmission assets previously included in retail rate base). However, the decision to provide unbundled retail wheeling is not the Commission's to make because we have no authority to order transmission directly to an ultimate consumer. In addition, even if a retail access program occurs, we do not believe the unbundling of retail transactions will radically change fundamental state authorities, including authority to regulate the vast majority of generation asset costs, the siting and maintenance of generation facilities and transmission lines, and decisions regarding retail service territories. Further, the Commission intends to be respectful of state objectives so long as they do not balkanize interstate transmission of power or conflict with our interstate open access policies. As the electric industry and state regulatory authorities continue to develop new competitive market structures and consider retail wheeling programs, we believe that the tests and mechanisms we have provided in this Rule will accommodate both Federal and state interests and will help provide jurisdictional certainty to market participants.

J. *Stranded Costs*

1. Justification for Allowing Recovery of Stranded Costs

In the Supplemental Stranded Cost NOPR, the Commission noted that the Open Access Rule would give a utility's historical wholesale customers greatly enhanced opportunities to reach new suppliers.[553] This would affect the way in which utilities have recovered costs under the traditional regulatory system that, on the one hand, imposed an obligation to serve,[554] and, on the other hand, permitted recovery of all prudently incurred costs. We noted that if customers leave their utilities' generation systems without paying a share of these costs, the costs will become stranded unless they can be recovered from other customers. The Commission stated in the NOPR that we must address the costs of the transition to a competitive industry by allowing utilities to recover their legitimate, prudent and verifiable stranded costs simultaneously with any final rule we adopt requiring open access transmission.[555]

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[553] *FERC Statutes and Regulations* ¶ 32,514 at p. 33,095.

Virtually all of the investor-owned utility commenters as well as commenters representing state commissions and other constituencies support the NOPR's premise that stranded costs can be created when a customer switches suppliers. They endorse the proposal to allow the recovery of legitimate and verifiable stranded tract, or a customer is seeking to shorten or eliminate the term of an existing contract, we believe that each have a heavy burden in demonstrating that the contract ought to be modified. Still, we believe that given the industry circumstances now facing us, both selling utilities and their customers ought to have an opportunity to make the case that their existing requirements contracts ought to be modified. By providing both buyers and sellers this opportunity, the Commission attempts to strike a reasonable balance of the interests of all market participants. The Commission expects that many of the arguments presented by buyers and sellers in such proceedings will be fact specific.

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[554] The supplemental Stranded Cost NOPR described such an obligation as explicit at retail and arguably implicit at wholesale, *FERC Statutes and Regulations* ¶ 32,514 at p. 33,101.

[555] Id. at p. 33,095-96, 33,10.1

c. Transition Period

We reaffirm our proposal to allow a public utility or its customer to file a proposed stranded cost amendment, or to allow a public utility or transmitting utility to file a proposal to recover stranded costs through a departing generation customer's transmission rates, at any time prior to the expiration of the contract. There is no uniform time remaining on requirements contracts executed on or before July 11, 1994. Any limitation on the period in which parties could propose amendments covering stranded costs (e.g., 3 years) would thus unequally affect market participants. Those with long terms remaining on their contracts could object that immediately addressing the issue would not be cost effective. For example, a utility with a long remaining term (e.g., 20 years) might not even seek stranded cost recovery depending on the competitive value of its assets near the end of the contract term.[691] However, such a utility would invariably seek to preserve its option to seek stranded cost recovery if its failure to do so within a short period resulted in a waiver of its right to do so. 6. Recovery of Stranded Costs Caused by Retail-Turned-Wholesale Customers

In the Supplemental Stranded Cost NOPR, we stated that both this Commission and state commissions have the legal authority to address stranded costs that result from retail customers becoming wholesale customers who then obtain transmission under the open access tariffs.[692] We proposed that this Commission should be the primary forum for addressing the recovery of stranded costs caused by retail-turned-wholesale customers, We explained that if a retail customer becomes a legitimate wholesale customer (such as through municipalization), it becomes eligible to use the non-discriminatory open access tariffs:

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[691] The value of its assets could vary over time as new technologies emerge, fuel costs fluctuate, or environmental requirements change.

[692] *FERC Statutes and Regulations* ¶ 32,514 at p. 33,127.

> If costs are stranded as a result of this wholesale transmission access, we believe that these costs should be viewed as "wholesale stranded costs." But for the ability of the new wholesale entity to reach another generation supplier through the FERC-filed open access transmission tariff, such costs would not be stranded.[693]

We accordingly proposed to define "wholesale stranded costs" to include stranded costs resulting from unbundled transmission for newly-created wholesale customers and sought comments on this definition.

We proposed to require the same evidentiary demonstration for recovery as that required if recovery were sought from a wholesale requirements customer. We reaffirmed our proposal in the initial Stranded Cost NOPR that a utility will have to show that the stranded costs are not more than the net revenues that the retail-turned-wholesale customer would have contributed to the utility had it remained a retail customer of the utility, and that the utility has taken and will take reasonable steps to mitigate stranded costs. We further proposed to deduct any recovery that a state has permitted from departing retail-turned-wholesale customers from the legitimate stranded costs of which we will allow recovery. In addition, we proposed to apply the same procedures for obtaining an estimate of maximum stranded cost exposure without mitigation to retail customers contemplating becoming wholesale transmission customers as those proposed for wholesale customers.[694]

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[693] Id. at p. 33,128.

[694] Id.

Some commenters contend that stranded costs that result when a retail customer becomes a wholesale customer should be left to the states as a matter of law and comity.[695] These commenters argue, among other things, that because the facilities used to provide retail service to these retail customers were subject to state jurisdiction and were included in retail rate base when the service was rendered, the state is the appropriate entity to determine the extent to which those customers should compensate the utility for the stranding of these costs. According to ELCON, "(a) retail customer's new found access to the wholesale market does not provide FERC with authority over costs that originated with the local distribution function."[696]

Commenters assert that stranded costs resulting from the creation of new wholesale entities will occur as a result of state or local decision making.[697] A number of commenters contend that in states where the state commission has control over municipalization, the Commission has no authority to provide for the recovery of stranded costs due to municipalization.[698] IL Com asserts that the Commission lacks authority over retail-turned -wholesale stranded costs, even in the absence of any explicit statutory authority for state commissions to address such costs. FL Com argues that the Commission should address the recovery of these, stranded costs only upon petition from a state public utility commission.

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[695] *E.g., NARUC, ELCON, TAPS, NASUCA, N.Y.* Mayors, NY Industrials, American Iron & Steel, Missouri Joint Commission, Omaha PPD, MI Com, NYU Com, NJ BPU, VT DPS, OK Com, IN Com, UT Com, WA Com, Environmental Action, IN Industrials, LA DWP, Seattle, CAMU, Las Cruces, UT Industrials, Suffolk County, NM Industrials, CO Consumers Counsel.

[696] ELCON Comments, dated July 25, 1995, at p. 41.

[697] *E.g.*, MD Com, MI Com, LA DWP, Las Cruces. For example, MD Com states that while open access transmission may make municipalization more attractive, it ultimately is MD Com's approval that makes municipalization possible in Maryland.

[698] *E.g.*, MD Com, Las Cruces, Caparo, Coalition on Federal-State Issues, IN Com, MI Com, Iowa Board.

According to some commenters, the availability of open access transmission tariffs does not convert the character of the costs of stranded generation that was built to serve retail customers from retail to wholesale.[699] CA Com argues that this reasoning could require the Commission to act as the primary forum for stranded costs resulting from retail wheeling if the Commission's jurisdiction over retail transmission is upheld. It argues that in such a case, there also would be a relationship between the Commission-jurisdictional transmission and stranded costs.

Some commenters also submit that the potential for retail customers to become wholesale customers has existed since the beginning of the industry and that utilities have had ample opportunity to adjust to this risk[700] A number of commenters submit that state commissions are in a better position than the Commission to address the recovery of costs that were incurred to serve retail customers and to take into consideration local concerns.[701]

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[699] *E.g.*, IL Com, CA Com, Midwest Commissions, CO Consumers Counsel.

[700] *E.g.*, LA DWP, Ohio Manufacturers, MMWEC, American Iron & Steel, UT Industrial, MI Com, NY Industrials, WA Com, Caparo.

[701] *E.g.*, American Iron & Steel, MD Com, LA DWP, Suffolk County, MI Com, NJ BPU, N.Y. Mayors. NASUCA cites practical problems posed by the Commission's proposal to assume jurisdiction over stranded costs resulting from municipalization, such as how the Commission would transfer the revenues extracted from the retail-turned-wholesale customer to a non-wholesale, locally-franchised entity.

NARUC recognizes that a "practical regulatory gap may exist that prevents (state commission) consideration of recovery of *** potentially stranded costs" in certain instances "such as municipalization and cooperatives, where retail customers become wholesale customers under a FERC-approved open access tariff, (and) costs of the utility which served the customer at retail may become stranded."[702] NARUC proposes that the affected states and the Commission collaboratively develop mechanisms (which may involve amendments to the FPA, state statutes. or both) to eliminate these regulatory gaps.

Some commenters object that the Commission's proposal to be the primary forum for recovery of stranded costs caused by retail-turned-wholesale customers would make municipalization more expensive and therefore would discourage municipalities from seeking alternative sources of electricity.[703] Some argue that different treatment of stranded costs between federal and state authorities may lead to forum-shopping as a primary determinant in the decision to municipalize.[704]

A number of commenters also suggest that the NOPR is inconsistent with prior Commission treatment of municipalization because the Commission has historically promoted franchise competition between municipalities and utilities and has never before suggested that utilities could "penalize" municipalization decisions through generation cost add-ons to transmission rates.[705] VT DPS states: "By the Commission's logic, there would never have been an Otter Tail case. If Otter Tail could have made a stranded cost claim against the municipal utility Elbow Lake planned to create, Otter Tail would never have needed to refuse to wheel."[706]

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[702] NARUC Initial Comments at p. 18-19.

[703] *E.g.*, N.Y. Mayors, NIEP, Wing Group, VT DPS, NY Industrials, American Iron & Steel, Environmental Action, IN Industrials, Las Cruces, Caparo,UT Industrials.

[704] *E.g.*, In Com.

Suffolk County states that the Commission already considered stranded costs in the context of retail-turned-wholesale customers in United Illuminating Company,[707] where the Commission required United Illuminating to remove a provision in its proposed transmission tariff that would have allowed it to recover stranded costs associated with former retail loads served by new municipal systems. Suffolk County states that the Commission made clear that stranded cost matters, including those caused by municipalization, properly would be raised before state regulatory authorities. It objects that the Open Access NOPR ignores this case. Suffolk County also submits that the Commission's adoption of the settlement approved by the Massachusetts DPU in the Massachusetts Bay Transportation Authority case should serve as an example of proper jurisdictional deference with respect to local issues.[708]

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[705] *E.g.*, VT DPS, American Iron & Steel, American Forest & Paper states that allowing stranded cost recovery in the event of municipalization would be inconsistent with the Commission's actions in the natural gas industry, where the Commission has encouraged competition at the retail level (through competitive bypass, rather than franchise competition) and has not imposed transition charges or exit fees on converting customers.

[706] VT DPS Intitial Comments at p. 49: see also American Iron & Steel, NY Industrials, Caparo.

[707] 63 FERC ¶61,212 (1993), reh'g denied, 64 FERC ¶61,087 (1993)

[708] See Massachusetts Electric Company, 68 FERC ¶ 61,101 (1994): Letter Order dated March 3, 1995, Docket No. ER94-129-000 (approving settlement).

However, many other commenters support the Commission's proposal to be the primary forum for retail-turned-wholesale stranded costs.[709] These commenters submit, among other things, that the Commission's jurisdiction over such costs is clear.[710] Coalition for Economic Competition states that when a utility's costs are stranded through the availability of Commission-jurisdictional transmission service, the Commission must address those costs. It argues that commenters opposing the Commission's jurisdiction fail to analyze the Commission's duty to establish just and reasonable rates for Commission jurisdictional transmission service.

A number of commenters support the Commission's proposal to address retail- turned-wholesale stranded costs on the basis that many state commissions either lack authority to address costs that are stranded because of expanding or newly created municipal systems, or have failed to address such costs.[711] El

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[709] *E.g.*, EEI, PSE&G, Centerior, Com Ed Consumers Power, Detroit Edison, Duke, El Paso, Energy, LILCO, Minnesota Power, Montana-Dakota Utilities, NYSEG, PECO, PG&E, PSNM, Southern, Utilities for Improved Transition, Allegheny, OH Com, Utilicorp, PA Com, WI Com, Coalition for Economic Competition, Central Louisiana, United Illuminating, Utility Investors Analysis, Nuclear Energy Institute, Utility Shareholders.

[710] *E.g.*, Consumers Power, Coalition for Economic Competition, Utilities For Improved Transition.

[711] *E.g.* Detroit Edison, Minnesota Power, El Paso, LILCO, Centerior, PG&E, PG&E urges a clarification in the rule so that the Commission would address retail-turned-wholesale stranded costs only if the state commission either lacks jurisdiction over municipal utilities, or, if it has jurisdiction, declines to address stranded costs. Where a state commission possesses jurisdiction over municipal entities and provides a utility with stranded cost recovery from former retail customers that have municipalized, PG&E proposes that such action should be final and not subject to Commission review. Other commenters, such as El Paso, ask the Commission to establish itself as the forum of last resort when states do not provide for full recovery of stranded costs.

Paso adds that any protection offered by state judicial condemnation proceedings does not obviate the need for the Commission's involvement in this issue, noting that condemnation awards may not provide full stranded investment recovery under the Commission's standards. In addition, El Paso suggests that municipalization may occur through means other than condemnation of the distribution systems of electric utilities, such as when a municipality constructs its own, duplicative distribution facilities.

Several commenters also indicate that by forthrightly addressing this issue, the Commission has removed a cloud of uncertainty that would have taken years to resolve through litigation.[712] El Paso states that the proposed rule is needed because utilities may be subject to stranded costs resulting from municipalization in two separate state jurisdictions.

In response to the argument that stranded costs are exclusively subject to state jurisdiction, SoCal Edison asserts that whether the costs are retail or wholesale is irrelevant because the issue is how and where these costs should be recovered. According to SoCal Edison, if the Commission finds that these costs are just and reasonable costs associated with providing open access transmission service, the Commission may allow utilities to recover them in Commission-regulated rates.

Coalition for Economic Competition notes that while utilities are aware of state laws allowing municipalities to condemn electric facilities and to form utilities, in recent decades, it has not happened on most systems. Moreover, it argues that merely being on notice that municipalization is a possibility does not relieve utilities of their state-imposed obligation to serve all customers in their franchise areas. It asserts that utilities had to continue to invest in plant to satisfy their duty to serve. In addition, it submits that utilities had a reasonable expectation that they would continue to serve retail load because, among other things, state regulators set long amortization periods of 30-40 years for depreciation rates.

Some commenters state that the Commission also should ensure that stranded costs are recovered when a municipal utility annexes territory served by another utility or otherwise expands its service territory.[713] A number of commenters also urge the Commission to ensure recovery of costs that are stranded if a municipal utility or a newly-formed wholesale or municipal utility physically interconnects to another utility or builds new transmission or distribution facilities to the municipal system.[714]

Several commenters believe that close coordination between the Commission and state regulators as to the calculation of stranded costs is important in the case of municipalization.[715] A number of state commissions suggest that the Commission allow the states to set the level of retail turned-wholesale stranded costs to be recovered in wholesale transmission rates set by the Commission.[716] They submit that this approach would respect state interests in controlling the rate impact of stranded costs, while allowing the Commission to design cost recovery, and would address the needs of industrial customers and other stakeholders by providing a forum before state regulators who will be more aware of their particular needs. Further, they contend that this approach would prevent relitigation of issues, minimize forum-shopping, and prevent legitimate and verifiable costs from falling through the cracks or being double-recovered.[717] NY Industrials asks the Commission to clarify that utilities will not be allowed to seek cost recovery at both the Commission and state commissions.

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[712] *E.g.* Coalition for Economic Competition, El Paso.

[713] *E.g.* EEI, Minnesota Power, Centerior, Public Service Co of CO, SoCal Edison, Coalition for Economic Competition, PG&E asks that we allow utilities to seek recovery at the Commission for stranded costs attributable to former retail customers that have become customers of existing public agencies or municipal utilities where such costs cannot be collected at the state level.

[714] *E.g.*, Centerior, Coalition for Economic Competition, PG&E. Coalition for Economic Competition proposes that the Commission accept just and reasonable regional stranded cost recovery mechanisms in such situations to enable regional transmission associations (whether through pool and interpool arrangements or regional transmission groups) to collect through Commission-filed rate schedules from interconnected utilities charges equal to the costs otherwise stranded as a result of Commission-jurisdictional service realignments.

[715] *E.g.*, SoCal Edison, OH Com, NY Com, MI Com, Coalition on Federal-State Issues.

Commission Conclusion

We reaffirm our preliminary determination that this Commission should be the primary forum for addressing the recovery of stranded Costs caused by retail-turned-wholesale customers. If such a customer is able to reach a new generation supplier because of the new open access (through the use of a FERC-filed open access transmission tariff or through transmission services ordered pursuant to Section 211 of the FPA), we believe that any costs stranded as a result of this wholesale transmission access should be viewed as "wholesale stranded costs." Such costs would not be stranded but for the action of this Commission (either through a mandatory FPA section 205-206 open access tariff or an order under FPA section 211) in permitting the new wholesale entity to become

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[716] *E.g.*, MI Com, NY Com, Ohio Com.

[717] PG&E proposes a similar approach, noting that if there are differences in the stranded cost method used by the Commission and the states, an incentive may remain for retail customers to municipalize merely to take advantage of more favorable stranded cost treatment at the Comission.

an unbundled transmission services customer of the utility and thereby to obtain power from a new supplier.[718] There is a clear nexus between the FERC-jurisdictional transmission access requirement and the exposure to non-recovery of prudently incurred costs. In these circumstances, we believe that this Commission should be the primary forum for addressing recovery of such costs. To avoid forum-shopping and duplicative litigation of the issue, we expect parties to raise claims before this Commission in the first instance.[719]

Some commenters have asked us also to be the primary forum for stranded cost recovery in situations in which an existing municipal utility annexes territory served by another utility or otherwise expands its service territory. We decline to do so because in these situations there is no direct nexus between the FERC-jurisdictional transmission access requirement and the exposure to non-recovery of prudently incurred costs. The risk of an existing municipal utility expanding its territory was a risk prior to the Energy Policy Act and prior to any open access requirement.

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[718] Costs that are exposed to nonrecovery when a retail customer or a newly-created wholesale power sales customer ceases to purchase power from the utility and does not use the utility's transmission system to reach a new generation supplier (e.g., through self-generation or use of another utility's transmission system) do not meet the definition of "wholesale stranded costs" for which this rule provides an opportunity for recovery. Such costs are outside the scope of this rule because such costs would not be stranded as a result of the new open access. See Section IV.J.12.

[719] We recognize that we took a different approach to retail-turned-wholesale stranded cost recovery in United Illuminating, where we suggested that state and local regulatory authorities or the courts should be able to provide an adequate forum to address retail franchise matters, including recovery of stranded costs caused by municipalization, but said we would consider revisiting the question if United Illuminating could demonstrate the lack of a forum, 63 FERC at p. 62,583-84. Since the issuance of that decision, however, we have had an opportunity to reanalyze the nature of the stranded cost problem in cases where a retail customer becomes a wholesale customer, including the potential that there might not be a state regulatory forum for recovery of such costs. In these circumstances, we have determined that where such costs are stranded as a result of wholesale open access transmission, these costs should be viewed as wholesale stranded costs and this Commission should be the primary forum for addressing their recovery.

Nevertheless, we are concerned that there may be circumstances in which customers and/or utilities could attempt, through indirect use of open access transmission, to circumvent the ability of any regulatory commission—either this Commission or state commissions—to address recovery of stranded costs.[720] We reserve the right to address such situations on a case-by-case basis.

As we indicated in the Supplemental Stranded Cost NOPR, if the state has permitted any recovery from departing retail-turned-wholesale customers (for example, if it imposed an exit fee prior to, or as a condition of, creating the wholesale entity), that amount will not, in fact, be stranded, and we will deduct that amount from the legitimate stranded costs for which we will allow recovery.

As discussed in Section IV.J.8-IV.J.9, we will require the same evidentiary demonstration for recovery of stranded costs from a retail-turned-wholesale customer, and will apply the same procedures for determining stranded cost obligation, as that required in the case of a wholesale requirements customer.

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[720] The CA Com has asked that, "(t)o the extent of FERC's authority, it should assume jurisdiction to fulfill a backstop role in case retail customers evade a state-determined transition charge by becoming retail customers of an entity not subject to the state regulatory commission's jurisdiction. In assuming jurisdiction, the Commission should defer to the state commission's determination and allocation of stranded costs for the departing retail customer." CA Com March 18, 1996 Response to Supplemental Comments of PG&E.

7. Recovery of Stranded Costs Caused by Retail Wheeling

In the Supplemental Stranded Cost NOPR, we stated that both this Commission and state commissions have the legal authority to address stranded costs that result from retail customers who obtain retail wheeling from public utilities in order to reach a different generation supplier.[721] Because the vast majority of commenters urged the Commission not to assume responsibility for retail stranded costs, except in certain circumstances, we preliminarily concluded that it is appropriate to leave it to state regulatory authorities to deal with any stranded costs occasioned by retail wheeling. We proposed to entertain requests to recover stranded costs caused by retail wheeling only when the state regulatory authority does not have authority under state law to address stranded costs at the time when the retail wheeling is required.[722] In so doing, we preliminarily accepted the view that stranded costs caused by retail wheeling are primarily a matter of local or state concern and thus, with the limited exception discussed above, generally must be recovered through retail charges.

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[721] As discussed in Section IV.I, the Commission's authority to address retail stranded costs derives from its jurisdiction over the rates, terms and condition of unbundled transmission interstate commerce used by retail customers that obtain retail wheeling. The states' authority derives from state jurisdiction over local distribution facilities and over the service of delivering electric energy to end users, and from the authority to impose, among other things, retail exit fees and surcharges on local distribution rates.

[722] We proposed to require the same evidentiary demonstration for recovery of stranded costs from a retail customer that obtains retail wheeling as that required in the case of a wholesale requirements customer. We also reaffirmed our proposal in the initial Stranded Cost NOPR that a utility will have to show that the stranded costs are not more than the net revenues that the retail customer would have contributed to the utility had it remained a retail customer of the utility, and that the utility has taken and will take reasonable steps to mitigate stranded costs. *FERC Statutes and Regulations* ¶32,514 at p. 33,128.

We noted that the states have a number of mechanisms for addressing stranded costs caused by retail wheeling, one of which is a surcharge to state-jurisdictional rates for local distribution.[723] We encouraged the states to use the mechanisms available to them to address stranded costs.[724] We also noted that the states may use their jurisdiction over local distribution facilities to address "stranded benefits", such as environmental benefits associated with conservation, load management, and other demand side management programs.[725]

A number of commenters support the Commission's proposal for addressing stranded costs caused by retail wheeling.[726]

Other commenters urge the Commission to take a greater role in retail stranded cost recovery and to entertain requests to recover stranded costs as a backstop where: (1) State regulatory authorities have the authority to address stranded costs but either choose not to exercise that authority or fail to permit full

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[723] As we noted in the Supplemental NOPR, a state may require payment of an exit fee before a franchise customer is permitted to obtain unbundled retail wheeling. If local distribution facilities are used by a retail wheeling customer, the state may allow recovery of stranded costs through rates for use of such local distribution facilities. In addition, as discussed in Section IV.I, because we believe that states have authority over the service of delivering electric energy to end users, not merely the local distribution facilities themselves, state authorities can assign stranded costs and benefits through a local distribution service charge, and may do so based on usage (kWh), demand (kW), or any combination or method they find appropriate. If a state decides not to take any of these routes, it may consider whether to allow recovery of stranded costs from remaining retail customers or whether shareholders should bear all or part of those costs. Id. at p. 33,129.

[724] Id. at p. 33,129-30.

[725] Id. at p. 33,0988 n.230.

[726] *E.g.*, Utilicorp, Houston L&P, PG&E, Freedom Energy Co. WI Com.

stranded cost recovery;[727] or (2) the state commission's authority is unclear.[728]

Commenters that support a greater Commission backstop role argue, among other things, that because the Commission has exclusive ratemaking jurisdiction over any stranded cost charges imposed "for or in connection with" interstate transmission service by public utilities, the Commission has an obligation to regulate the recovery of stranded costs from interstate retail transmission customers.[729] A number of these commenters argue that the determining factor is who has the jurisdiction to review the rates for the service, not who has the jurisdiction to order the service.[730] They explain that the Commission has jurisdiction over generating facilities and associated costs to the extent appropriate to establish just and reasonable rates for jurisdictional services. They disagree with other commenters who argue that only the jurisdiction under whose authority the costs were incurred and initially recovered should have authority to order recovery of stranded costs.[731]

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[727] *E.g.*, EEI, EGA, Coalition for Economic Competition, Utilities for Improved Transition, Atlantic City, Arizona, Centerior, Com Ed, Detroit Edison, El Paso, LILCO, NU, NSP, NYSEG, United Illuminating, BG&E, Sierra Souther, UT Industrials, NRECA. NRECA argues that unless the Commission addresses stranded costs caused by retail wheeling where a state commission lacks authority, or has authority but decides not to exercise it, there could be a jurisdictional gap into which many rural electric cooperatives could fall.

[728] *E.g.*, CSW.

[729] *E.g.*, EEI, Illinois Power, PSNM, Entergy, Nuclear Energy Institute, Coalition for Economic Competition.

[730] *E.g.*, Coalition for Economic Competition, Illinois Power, Utilities for Improved Transition, EEI.

These commenters contend that the Commission cannot abdicate its regulatory responsibilities by either deferring to the state commissions or otherwise failing to independently address the issue.[732] EEI and the Coalition for Economic Competition refer to "a long line of cases (where) the courts have held that where a federal regulatory agency * * * is charged with implementing a statutory framework, that agency is without authority to deviate from or abdicate its statutory responsibilities.[733] According to Coalition for Economic Competition. for example, the Commission could satisfy its obligation to address stranded costs that arise from retail wheeling by allowing states to determine retail stranded cost charges in the first instance; to the extent that the state allows full recovery. Coalition for Economic Competition submits that the Commission's obligation would be satisfied.

EEL asserts that it would be unduly discriminatory and preferential for the Commission to refuse to address all stranded costs arising from retail wheeling. According to EEL, the same arguments that support the Commission's decision to address costs that are stranded where retail load municipalizes and

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[731] EEI notes, for example, that as use of electrical facilities shifts between retail and wholesale, jurisdiction over the rates to recover the allocated cost of service shifts between state commissions and this Commission, and that the regulatory authority is determined by the nature of the transactions and the classification of the customer, not the jurisdiction under which the costs originally arose.

[732] *E.g.*, Illinois Power, Utilities For Improved Transition, EEI, Coalition for Economic Competition.

[733] EEI Initial Comments at IV-13: see also Coalition for Economic Competition Initial Comments at p. 23-31.

where the state regulatory authority, at the time retail wheeling is required, lacks authority to act, apply with equal force to all other retail stranded costs. EEL submits that the nexus in these cases is that Commission-jurisdictional transmission service is the means by which the costs are stranded.[734]

Utility Working Group argues that the NOPR inappropriately characterizes the Commission's jurisdiction over retail stranded costs and that this could later be used against the Commission's exercise of its full authority. According to Utility Working Group, the NOPR depicts the Commission's jurisdiction as being derived from state law (in other words. the Commission will act where state regulatory authorities have no authority over retail stranded costs and will not act where state regulatory authorities have such authority). If the Commission desires to afford substantial deference to the states regarding retail stranded costs, Utility Working Group contends that the final rule should reflect that policy determination; however, the rule should not confuse policy with jurisdiction by purporting to place limits on, or attempting to waive, the Commission's jurisdiction over such costs.

Entergy asserts that the Commission's jurisdiction over multi-state utilities provides further support for our jurisdiction over retail stranded costs in certain contexts. Entergy states that most of the eleven multi-state registered holding company systems have some form of Commission-jurisdictional agreement that allocates production and transmission costs among the systems' affiliated operating companies. It asserts that these agreements by their very nature allocate costs among jurisdictions (that is, between states). Many of these agreements equalize the cost of generating reserves among affiliated operating companies, and such reserve equalization formulas can shift retail stranded costs amorng states unless the Commission provides a regulatory forum to address cost-shifting. Citing Middle South Energy,[735] and City of New Orleans v. FERC,[736] Entergy submits that the Commission cannot sit on the sidelines when it comes to stranded retail costs on the Entergy system. According to Entergy, Commission and judicial precedent place on the Commission the responsibility to ensure that federally-approved costs and cost allocations are not undermined by state action.

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[734] See also SoCal Edison.

Commenters also express concern that it will not be possible to be sure that a state regulatory authority has authority over retail stranded costs until after years of litigation. If the Commission waits for the resolution of challenges to state authority and a court holds that the state regulatory authority is without authority, these commenters assert that the bar on retroactive ratemaking could leave the states and the Commission without a remedy to compensate utilities for stranded costs.[737] A number of commenters suggest that while the states should be allowed to set retail wheeling stranded cost charges in the first instance, the Commission should accept filings to preserve a utility's ability to recover retail stranded costs from the time the customer departs if the state-authorized charges are not upheld in court. They submit that this would put customers on notice of the potential for Commission action and thereby avoid the retroactivity problem.[738]

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[735] Opinion 234, 31 FERC ¶61,305, on reh'g, 32 FERC ¶61,425 (1985).

[736] 875 F.2d 903 (D.C. Cir. 1989), cert. denied sub nom. *Mississippi v. FERC*, 494 U.S. 1078 (1990).

[737] *E.g.*, NU, Coalition for Economic Competition, Illinois Power, EEI.

[738] *E.g.*, NEPCO, EEI, Coalition for Economic Competition Entergy.

Some commenters express concern that if the Commission does not take more decisive action on retail wheeling stranded costs, the result will be wasteful litigation that will discourage competition by causing financial uncertainty and higher financing costs for investor-owned utilities and higher rates for consumers.[739]Coalition for Economic Competition also asserts that stranded cost charges would be greatest at the start of a retail wheeling program, thereby making the years during which the state-authorized charges are subject to appeal more important for recovery purposes.

A number of commenters support Commission-established uniform standards for, and uniform recovery of, costs stranded as a result of open access to the interstate transmission system.[740] They argue that disparate state treatment of stranded costs would be economically inefficient and discriminatory and would burden interstate commerce.[741] Several commenters support state involvement in the establishment of uniform standards.[742]

In contrast to the commenters that support a greater Commission role in retail stranded cost recovery. NARUC and a number of other commenters oppose any Commission involvement in retail stranded costs.[743] These commenters contend, among other things, that the Commission lacks authority over these costs. Even if the Commission could assert such jurisdiction, they argue that as a policy matter it would be inappropriate for the Commission to delve into complicated legal and policy issues governed by varying state regulatory regimes.

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[739] *E.g.*, LILCO, Coalition for Economic Competition.

[740] *E.g.*, NU, NSP, Illinois Power, Coalition for Economic competition, PSE&G, Utilities for Improved Transition, Philip Morris, EEI.

[741] Freedom Energy Co. rejects this argument on the basis that state regulation has never been wholly consistent and yet utilities have not asked for federal unification of state ratemaking policies or resolution of differences.

[742] *E.g.*, PSNM, GA Com, Omaha PPD, Illinois Power.

According to some of these commenters,[744] section 201(a) of the FPA precludes an exercise of federal jurisdiction over retail stranded cost recovery because the Commission's jurisdiction extends "only to those matters which are not subject to regulation by the States."[745] NM Industrials argues that a lack of state commission authority is an affirmative state determination, either by act or omission, that stranded costs must be dealt with in a particular manner. It submits that the Commission also lacks authority over retail stranded costs when states either decide not to address such costs or, in the Commission's opinion, grant insufficient recovery of stranded costs. NM Industrials asserts that the language of the FPA and its legislative history indicate that Congress wanted to preclude Commission jurisdiction in those areas where states could exercise effective control, and that this limitation covers all matters which are or can be regulated by the states, including the recovery of stranded investment. NM Industrials also suggests that assertion of Commission jurisdiction would violate the

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[743] *E.g.*, CA Com, MD Com, VA Com, IN Com, NH Com, NV Com, NY Com, OH Com, FL Com, AZ Com, TX Com, ELCON, NY Industrials, NY AG, NY Consumer Protection, MA DPU, Iowa Board, IN Industrials, Texas Industrials, NM Industrials, Reynolds, NYMEX, Legal Environmental Assistance, CO Consumers Counsel, NJ Ratepayer Advocate, IBM, ME Industrials, Jay, WEPCO, NH General Court.

[744] *E.g.*, NARUC, ELCOM, NY Industrials, NM Industrials, NV Com.

[745] 16 U.S.C. 824(a)

provision of section 212 of the FPA that prohibits the Commission from interfering with the states' authority over the transmission of energy directly to an ultimate consumer.[746]

Other commenters argue that the Commission's proposed treatment of retail stranded costs infringes on the states' jurisdiction over the allocation of costs that were under their jurisdiction when the costs were incurred. According to these commenters, the question of whether these costs should be recovered from other retail ratepayers, eliminated as excess capacity, or billed in some fashion to the customer now receiving wheeling service are purely questions of state ratemaking law.[747] Some commenters assert that. as a matter of policy, the Commission should stay out of retail stranded costs because only the states have sufficient knowledge and expertise regarding utility planning, investment, and forecasting to address these costs adequately.[748]

Commenters also express concern that the possibility of Commission involvement in retail stranded cost recovery will encourage forum-shopping whenever state commission action is unfavorable, even when states have procedures to deal with stranded costs. They argue that the result would be endless litigation over where federal jurisdiction ends and where state jurisdiction begins. They suggest that if a state fails to address retail stranded cost recovery, the issue should be addressed in court or in state legislatures.[749] OH Cam contends that a Commission policy that does not recognize states' authority over retail stranded costs would be a disincentive for states to permit retail wheeling.

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[746] See also *Freedom Energy Co. Reply Comments.*

[747] *E.g.*, ELCON, PA Com, NY Industrials, ND Com, VA Com, NM Com.

[748] *E.g.*, OH Com, NY Industrials, NM Com, IN Com, WA Com, NV Com, NY Com, Suffolk County, NY AG, Tonko, PA Industrials, NH General Court.

A number of commenters argue that recovery of retail stranded costs is not directly implicated by any Commission or Congressional action—that most such costs would be created by retail wheeling, which is not the subject of the Commission's open access initiatives—and thus need not be dealt with as part of the final rule.[750]

Commenters seek a number of clarifications concerning the Commission's position on, and the procedures for, retail stranded cost recovery. A number of commenters ask the Commission to clarify the states' role with respect to retail stranded cost recovery.[751] Others address the type of evidence required to establish that the State regulatory authority lacks authority to address stranded costs when retail wheeling is required.[752]

Several commenters express concern that customers receiving retail wheeling not be able to evade state stranded cost charges.[753] IL Com says that the Commission's proposal for determining whether facilities are state-jurisdictional "local

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[749] *E.g.*, OH Com, PA Com, NM Com, CA Com, Blue Ridge.

[750] *E.g.*, Nucor, AEC & SMEPA.

[751] *E.g.*, NY Industrials, EGA, NJ BPU, Coalition on Federal-State Issues.

[752] *E.g.*, Iowa Board, Nevada Commission, CCEM: see also NE Public Power District.

[753] *E.g.*, IL Com, PG&E, Public Service Co. of CO.

distribution" facilities or Commission-jurisdictional "transmission" facilities in interstate commerce may not always, provide a state, with the opportunity to recover retail stranded costs through distribution rate surcharges. It says that the Commission does not offer any assurances that the case-by-case application of the proposed "functional-technical test" will result in a finding that "local distribution" facilities are used in all retail wheeling scenarios. PG&E asks the Commission to provide that all retail customers that opt for direct transmission access by definition take service over local distribution facilities and therefore may be subjected to a state-determined distribution rate that includes stranded cost surcharges.

A number of commenters ask the Commission to clarify that, in issuing the final rule, the Commission is not endorsing (either implicitly or explicitly) retail wheeling.[754]

Several commenters express concern that stranded costs may arise in one state jurisdiction and be shifted to another.[755] For example, MT Com says that an analysis confined to a state's boundaries may reveal no stranded costs, but that such costs may indirectly arise because of common pool revenue recovery mechanisms, which may be the largest source of stranded costs for some utilities. Entergy raises a similar concern in the context of holding company or other multi-state situations. It argues that denial of retail stranded cost recovery by a state regulatory authority could harm customers in other states. Entergy proposes that, while state regulators should be given the opportunity in the first instance to assure that stranded costs are recovered and are not shifted to other states, the Commission should allow utilities to file retail wheeling tariffs with the

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[754] *E.g.*, NRECA, Wisconsin, EC, EEI, PECO, Missouri Basin Group.

[755] *E.g.*, MT Com, Entergy.

Commission to preserve the right to seek recovery from the Commission.

Several commenters oppose Entergy's proposal.[756] Among other things, they argue that the FPA does not authorize the Commission to act as an appellate court over retail regulators. They assert that, in the case of a multi-state holding company system, it is the Commission-jurisdictional intra-system agreement (not a state's decision as to recovery of retail stranded costs) that determines the allocation of costs at wholesale among the affiliates. Several of these commenters suggest that if the holding company believes that, as a result of a state's disallowance of costs in retail rate base, the cost allocations under an intra-system agreement are unduly discriminatory, the holding company could propose to amend the agreement.[757]

A number of commenters also express concern that services that investor-owned utilities provide to promote energy efficiency and conservation and to assist low-income residents and the elderly be continued.[758] NW Conservation Act Coalition suggests that the Commission should condition stranded cost recovery upon a showing by the utility that allowing recovery will not strand such social benefits.[759]

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[756] *E.g.*, NARUC, Entergy Retail Regulators, MS Com, Al Com.

[757] *E.g.*, NARUC, MS Com.

[758] *E.g.*, Homelessness Alliance, Black Mayors, National Women's Caucus, Vann, La Raza.

[759] NARUC and OH Com assert that, in determining whether a wholesale transmission transaction is a "sham," the Commission should consider a retail customer's intent to bypass responsibility for supporting social programs.

Various commenters endorse the use by state regulators of a distribution charge or other fee imposed on electricity consumption to address stranded social benefits.[760] NARUC and OH Com express concern that the Commission, by claiming authority over unbundled retail transmission services, may make it difficult for states to use non-bypassable "wires charges" or "access fees" to require all customer classes to support such program.[761] NARUC asks the Commission to ensure that any jurisdiction we exercise over unbundled transmission services does not legally or practically foreclose the ability of individual states to fund such programs.[762] LILCO, as part of its argument that the Commission should provide a complete backstop for stranded cost recovery resulting from retail wheeling, urges the

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[760] *E.g.*, Natural Resources Defense, NW Conservation Act Coalition, Seattle, FTC, Northeast States for Coordinated Air Use Management, NARUC, OH Com, CO Com agrees that states should have the option to fund such programs through the imposition of surcharges on any form of electric service used to benefit retail customers, including surcharges on retail transmission rates. Seattle proposes either a simple fee on kWhs or a differential fee based on the type of resource and its environmental affects. DOE urges the Commission to work with state regulators to ensure that states have the ability to recover stranded retail costs and benefits in a way that prevents cost-shifting, forum-shopping, and uneconomic bypass (including bypass of stranded benefits).

[761] CO Com notes that the NOPR proposes to limit states to funding mechanisms that can be implemented solely at the local distribution level, presumably through the use of a surcharge on distribution facilities or so-called "fee at the meter" or the use of a local distribution system revenue decoupling mechanism. It suggests that neither of these options may be legally or practically feasible in many states for a wide variety of reasons (but does not expand on these reasons).

[762] Natural Resources Defense proposes that the Commission adopt the following language: "The FPA does not affect state regulators' jurisdiction to apply distribution charges—either volume-based or fixed—to electricity that is used by any utility customer to provide end-use services (as distinguished from electricity that is purchased for resale to end-use customers). Natural Resources Defense Initial Comments at p. 3.

Commission to establish retail wheeling rates that provide for full recovery of any stranded costs. including stranded social benefits, that are unrecovered after state stranded cost determinations.

Commission Conclusion

We believe that both this Commission and the States have the legal authority to address stranded costs that result when retail customers obtain retail wheeling in order to reach a different generation supplier, and that utilities are entitled, from both a legal and a policy perspective, to an opportunity to recover all of their prudently incurred costs. This Commission's authority to address retail stranded costs is based on our jurisdiction over the rates, terms, and conditions of unbundled retail transmission in interstate commerce. The authority of state commissions to address retail stranded costs is based on their jurisdiction over local distribution facilities and the service of delivering electric energy to end users. However, because it is a state decision to permit or require the retail wheeling that causes retail stranded costs to occur, we will leave it to state regulatory authorities to deal with any stranded costs occasioned by retail wheeling. The only circumstance in which we will entertain requests to recover stranded costs caused by retail wheeling is when the state regulatory authority[763] does not have authority under state law to address stranded costs when the retail wheeling is required.

Commenters that describe our action as an unlawful abdication or delegation of authority misconstrue the nature of our decision to leave retail stranded costs (with a limited exception) to state

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[763] "State regulatory authority" has the same meaning as provided in section 3(21) of the FPA.

regulatory authorities.[764] We have not "abdicated" or "delegated" to state regulatory authorities our jurisdiction over the rates, terms, and conditions of retail transmission in interstate commerce; if retail transmission in interstate commerce by a public utility occurs, public utilities offering such transmission must comply with the FPA by filing proposed rate schedules under section 205. Instead, we have made a policy determination that the recovery of retail stranded costs—an issue over which either this Commission or state commissions could exercise authority by virtue of their jurisdiction over retail transmission in interstate commerce and over local distribution facilities and services, respectively—is primarily a matter of local or state concern that should be left with the state commissions. However, if the state regulatory authority does not have authority under state law to address stranded costs when the retail wheeling is required, then we will entertain requests to recover such costs.[765]

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[764] We reject the arguments of EEI and Coalition for Economic Competition that the Commission made findings in the initial stranded cost NOPR that "inexorably" lead to the conclusion that Commission action providing full recovery of retail stranded costs is required. Their reliance on *Williams Natural Gas Company v. FERC*, 872 F.2d 438 (D.C. Cir. 1989), appeal after remand, 943 F.2d 1320 (D.C. Cir. 1991) (Williams), is simply misplaced. Williams involved a rulemaking that was terminated by the Commission. The court stated that the Commission, "having expressed these tentative views (that the incentive price for tight formation gas would disserve the public interest) and having solicited comments on the issue, was not free to terminate the rulemaking" without providing a satisfactory explanation. 872 F.2d at p. 446, 450. Here, in contrast, we are issuing a Final Rule that reaffirms in many aspects preliminary findings proposed in both the initial and Supplemental Stranded Cost NOPRs. Although the conclusion we reach based on those findings may be different than that which some commenters advocate, we have fully explained the basis for our decision.

[765] In these circumstances, the cases cited by commenters to support the proposition that an agency is not authorized to abdicate its statutory responsibilities or to delegate to parties and intervenors regulatory responsibilities (such as preparation of an environmental impact statement) are factual distinguishable and inapposite. *See, e.g.*, FPC v. Texaco, 417

Because we have accepted the view that stranded costs caused by retail wheeling are primarily a matter of local or state concern, we will not allow the states to use the interstate transmission grid as a vehicle for passing through any retail stranded costs, with the following limited exception. If the state regulatory authority does not have authority under state law when the retail wheeling is required to resolve the retail stranded cost issue, we will permit a utility to seek a customer-specific surcharge to be added to an unbundled transmission rate.

We believe that most states have a number of mechanisms for addressing stranded costs caused by retail wheeling.[766] In addition, as further discussed in Section IV.I we are defining in this rule "facilities used in local distribution" under section 201(b)(1) of the FPA. Rates for services using such facilities to make a retail sale are state-jurisdictional, and states will be free to impose stranded costs caused by retail wheeling on facilities or services used in local distribution. States may also use their jurisdiction over local distribution facilities or services to recover so-called stranded benefits, This, rule is not intended to preempt any existing state authority to assess a stranded cost or stranded benefits charge on a retail customer that obtains retail wheeling. Moreover, since the charge is state jurisdictional, it is of no

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U.S. 380, 394 (1974) (Commission cannot exempt small-producter rates from compliance with just and reasonable standard): *United States v. City of Detroit*, 720 F.2d 443, 451 (6th Cir. 1983) (district court inappropriately implied waiver of EPA statutory duty under Title 11 of the Federal Water Pollution Prevention and Control Act): *State of Idaho v. ICC*, 35 F.3d 585, 595-96 (D.C. Cir. 1994) (an agency cannot abdicate its NEPA responsibilities in favor of the regulated party).

[766] As discussed in the Supplemental NOPR (FERC *Statutes and Regulations* ¶32,514 at p. 33,129-30), these mechanisms include requiring an exit fee before a franchise customer is permitted to obtain unbundled retail wheeling and imposing a surcharge on local distribution rates. Commenters identified several other possible mechanisms in response to the initial Stranded Cost NOPR.

moment to our responsibilities under the FPA as to whether such charges are volume-based (kWh), demand-based kW), or customer based (fixed).

We believe that our approach to retail wheeling stranded costs represents an appropriate balance between federal and state interests. This approach ensures, that the rates for transmission in interstate commerce by public utilities (except in a narrow circumstance) will not be burdened by retail costs. It also helps to ensure that one State will not be able to impose costs stranded by its ordering of retail wheeling[767] on customers in another state.[768] In a holding company or other multi-state situation, we recognize that denial of retail stranded cost recovery by a state regulatory authority could, through operation of the reserve equalization formula in a Commission-jurisdictional intra-system agreement, inappropriately shift the disallowed costs to affiliated operating companies in other states. The Commission is concerned about this potential for cost-shifting. We would not wish to see an intra-system agreement used as a means for one jurisdiction to shift to other jurisdictions retail stranded costs for which it would otherwise be responsible under that agreement. However, we will deal with such situations if they arise pursuant to public utility filings under section 205 or complaints under section 206. Thus, the need to amend a jurisdictional agreement to prevent retail stranded costs from being shifted to customers in other states will be addressed on a case-by-case basis. We encourage the affected state commissions in such situations to seek a mutually agreeable approach to this potential problem. If such a consensus solution resulted in a filing to modify a jurisdictional agreement, we would accord such a proposal deference, particularly if other interested parties support the filing. In the event that the state commissions and other interested parties cannot reach consensus that would prevent cost shifting, the Commission would ultimately have to resolve the appropriate treatment of such stranded costs.

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[767] As we stated in the Supplemental NOPR, we do not address whether states have the lawful authority to order retail wheeling in interstate commerce. Id. at p. 33, 098 at n.228. In addition, we are neither endorsing nor discouraging retail wheeling.

[768] See id. at p. 33,098, 33,127-28.

Should a situation arise in which a state regulatory authority concludes that it has no ability to address retail stranded costs, or the appropriate state courts ultimately determine that a state regulatory authority does not have authority to impose retail stranded costs, a utility may seek recovery here through its Commission-jurisdictional retail transmission rates of costs stranded as of the date of the customer's departure. Because all parties are put on notice by this Rule of the potential for recovery through Commission-jurisdictional retail transmission rates should state commission-authorized retail wheeling charges be invalidated, such recovery (if allowed) would not be retroactive ratemaking.[769]

8. Evidentiary Demonstration Necessary—Reasonable Expectation Standard

In the Supplemental Stranded Cost NOPR, the Commission made a preliminary determination that a public utility or transmitting utility seeking to recover stranded costs must demonstrate that it had a reasonable expectation of continuing to serve a customer. We indicated that the existence of a notice of termination provision in a wholesale requirements contract creates a rebuttable presumption that the utility had no reasonable expectation of serving the customer beyond the period

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[769] *See Public Utilities Commission of the State of California v. FERC*, 988 F.2d 154, 163-66 (D.C. Cir. 1993).

provided for in the notice provision.[770] We proposed not to adopt a mini-

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Ohio Edison Company
Ohio Valley Electric Corporation
Oklahoma Gas & Electric Company
Old Dominion Electric Cooperative
Otter Tail Power Company
Pennsylvania Power Company
Peoples Electric Cooperative
Rayburn Country Electric Cooperative
Rochester Gas & Electric Corporation
Sierra Pacific Power Company
South Beloit Water, Gas & Electric Company
St. Joseph Light & Power Company
Superior Water Light and Power Company
Texas-New Mexico Power Company
Toledo Edison Company
Tucson Electric Power Company
UGI Utilities. Inc.
Union Electric Company
Union Light, Heat, & Power Company
Union Power Corporation
Upper Penninsula Power Company
Vermont Electric Transmission Company
Vermont Electric Power Company
Virginia Electric & Power Company
Yadkin, Inc.

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[770] *FERC Statutes and Regulations* ¶ 32,514 at p. 33,117.

Appendix G

I. Legal Analysis of Commission Jurisdiction Over the Rates, Terms and Conditions of Unbundled Retail Transmission in Interstate Commerce

Based on an analysis of the relevant legislative history and case law under the Federal Power Act (FPA), the Commission concludes that it has exclusive jurisdiction over the rates, terms and conditions of the unbundled transmission in interstate commerce, by a public utility, of electric energy to an end user. This is also known as retail wheeling in interstate commerce.[1]

The Commission's jurisdiction over the rates, terms and conditions of transmission in interstate commerce derives from Congress' power to regulate interstate commerce under the United States Constitution[2] and the FPA. When Congress enacted the FPA, it gave the Commission exclusive jurisdiction over the rates, terms and conditions of transmission in interstate commerce by public utilities. The Supremacy Clause of the Constitution provides that federal laws enacted pursuant to the powers delegated to the federal government by the United States Constitution are the supreme law of the land.[3] Accordingly, to the extent that retail wheeling involves transmission in interstate commerce by public utilities, the rates, terms and conditions of

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[1] Section 212(h) of the FPA provides tat no order issued under the FPA shall be conditioned upon or require the transmission of electric energy directly to an ultimate consumer. 16 U.S.C. § 824k(h). The Commission's assertion of jurisdiction in this final rule is over the rates, terms and conditions of retail transmission that occurs voluntarily or as a result of a state retail access program.

[2] U.S. Const. Art I, Section 8, cl.3.

[3] U.S. Const. Art, VI.cl.2.

such service are subject to the exclusive jurisdiction of the Commission, and must be filed with the Commission.[4]

1. Relevant Federal Power Act Provisions

Section 20 1(b)(1) of the FPA provides:

> The provisions of this Part shall apply to the transmission of electric energy in interstate commerce and to the sale of electric energy at wholesale in interstate commerce* * *. The Commission shall have jurisdiction over all facilities for such transmission or sale of electric energy, but shall not have jurisdiction * * * over facilities used in local distribution or only for the transmission of electric energy in intrastate commerce, or over facilities for the transmission of electric energy consumed wholly by the transmitter.

16 U.S.C. 824(b)(1) (emphasis added).
Thus, the statute on its face limits Commission jurisdiction over sales of energy to sales at wholesale, but does not limit jurisdiction over transmission to transmission used only for wholesale sales.

Sections 201(c) and (d) define the meaning of "the transmission of electric energy in interstate commerce" and "sale of electric energy at wholesale in interstate commerce." Section 201(c) provides:

> For the purpose of this Part, electric energy shall be held to be transmitted in interstate commerce if transmitted from a State and consumed at any point outside thereof; but only insofar as such transmission takes place within the United States.

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[4] *See Montana-Dakota Utilities Co. v. Northwestern Public Service Co.*, 341 U.S. 246, 251-52 (1951) (*Montana-Dakota).*

16 U.S.C. 824(c). Section 201(d) provides:

> The term "sale of electric energy at wholesale" when used in this Part means a sale of electric energy to any person for resale.

16 U.S.C. 824(d).

Sections 205 and 206 of the FPA give the Commission jurisdiction over the rates, terms and conditions of transmission in interstate commerce, and sales at wholesale in interstate commerce, by public utilities. 16 U.S.C. 824d and 824e.

2. Legislative History and Case Law

Much of the legislative history, of the FPA indicates that Congress intended the Commission's jurisdiction to extend only to those matters which the Attleboro decision[5] held to be beyond the reach of the States. For instance, the report accompanying the Senate bill states that subsection (b) "leaves to the States the authority to fix local rates even in cases where the energy is brought in from another State."[6] In other words, states retain authority to regulate rates of electric energy to ultimate consumers. The Senate report also states:

> The rate-making powers of the Commission are confined to those wholesale transactions which the Supreme Court held in (Attleboro) to be beyond the reach of the States. Jurisdiction is

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[5] *Public Utilities Commission v. Attleboro Steam & Electric Co.*, 273 U.S. 83 (1927) (Attleboro). In Attleboro, the Supreme Court held that State regulation of the interstate sale of electricity was barred by the Commerce Clause because such regulation would impose a "direct burden" on interstate commerce.

[6] S. Rep. No. 621, 74th Cong., 1st Sess. 48 (1935). See also H.R. Rep. No. 1318, 74th Cong., 1st Sess. 8 (1935).

> asserted also over all interstate transmission lines whether or not there is sale of the energy carried by those lines and over the generating facilities which produce energy[7] for interstate transmission and sale.

S. Rep. No. 621, 74th Cong., 1st Sess. 48 (1935) (emphasis added). Thus, federal jurisdiction over transmission lines is not dependent on whether those lines are used to effect a sale, wholesale or otherwise.

The provisions of FPA section 201 reserving certain regulatory authority to the States have been interpreted narrowly.[8] The Supreme Court has stated:

> In section 201(b), Congress did no more than leave standing whatever valid state laws then existed relating to the exportation of hydroelectric energy; by its plain terms, section 201(b) simply saves from preemption under Part II of the Federal Power Act such state authority as was otherwise "lawful."[9]

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[7] The provisions of the Senate bill regarding federal jurisdiction over generating facilities were eliminated from the final version of the bill.

[8] Section 201(a) declares that Federal regulation of the transmission of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce is necessary in the public interest, "such Federal regulation, however, to extend only to those matters which are not subject to regulation by the States." 16 U.S.C. § 824(a), Section 201(b)(1) states that the provisions of Part II of the FPA apply to the transmission of electric energy in interstate commerce and the sale of electric energy at wholesale in interstate commerce but, except as specifically provided, "shall not apply to any other sale of electric energy or deprive a State or State commission of its lawful authority now exercised over the exportation of hydroelectric energy which is transmitted across a State line." 16 U.S.C. § 824(b)(1).

[9] *New England Power Co. v. New Hampshire*, 455 U.S. 331, 341 (1982) (NEPCO).

The Court also stated:

> Nothing in the legislative history or language of the statute evinces a congressional intent 'to alter the limits of state power otherwise imposed by the Commerce Clause.' * * * or to modify the earlier holding of this Court concerning the limits of state authority to restrain interstate trade.[10]

Unlike the narrow interpretations given to the FPA provisions reserving certain regulatory authority to the States,[11] the courts have construed transmission "in interstate commerce" broadly. The term does not turn on whether the contract path for a particular power or transmission sale crosses state lines, but rather follows the physical flow of electricity. Because of the highly integrated nature of the electric system, this results in most transmission of electric energy being "in interstate commerce."

One of the earliest cases construing Commission jurisdiction over transmission was Jersey Central Power & Light Co. v. FPC, 319 U.S. 61 (1943) (Jersey Central). In that case, the Commission asserted jurisdiction over a New Jersey utility by showing that the utility owned transmission facilities that were used to transmit energy in interstate commerce. The Court found that the Commission had demonstrated that the utility owned transmission facilities that were indirectly interconnected, through a second New Jersey utility, to facilities owned by a

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[10] *Id.* (citation omitted).

[11] While Congress may exercise its Commerce Clause authority to grant the States that "ability to restrict the flow of interstate commerce that they would not otherwise enjoy," Lewis v. BT Investment Managers, Inc., 447 U.S. 27, 44 (1980). States may not exercise such regulatory powers unless Congress has expressly stated its intention to take such an affirmative grant of power. *NEPCO*, 455 U.S. at p. 343.

New York utility and that the facilities were used to transmit electric energy in interstate commerce.

The Court noted that section 201(c) of the FPA defines electric energy "transmitted in interstate commerce to be energy transmitted from a State and consumed at any point outside thereof." The Court stated:

> It is impossible for us to conclude that this definition (of transmission in interstate commerce) means less than it says and applies only to the energy at the instant it crosses the state line and so only to the facilities which cross the line and only to the company which owns the facilities that cross the line.

319 U.S. at 71. Thus, a critical question regarding the jurisdictional status of a wheeling transaction is whether the facilities used to provide the service transmit electric energy in interstate commerce.

In Connecticut Light & Power Co. v. FPC. 324 U.S. 515 (1945) (CL&P), the Court reviewed the Commission's finding that a Connecticut utility was jurisdictional because it owned transmission facilities that were used in interstate commerce. The Court generally embraced the Jersey Central standard for determining whether facilities are used to transmit electric energy in interstate commerce. The Court emphasized that whether certain facilities transmit electric energy in interstate commerce is more a technical than a legal question. The Court stated:

> Federal jurisdiction was to follow the flow of electric energy, an engineering and scientific, rather than a legalistic or governmental, test.

324 U.S. at 529. Thus, the Court adopted the Jersey Central test providing that the Commission's jurisdiction generally extends

to transmission facilities that transmit electric energy in interstate commerce.

The Court also applied the Jersey Central test in FPC v. Florida Power & Light Co., 404 U.S. 453 (1972), affirming the Commission's finding of jurisdiction over a Florida utility. The Commission demonstrated that the utility transmitted power to another Florida utility's "bus"[12] and that power was simultaneously transferred from the "bus" to a Georgia utility. The Court upheld the Commission's finding that electric energy from the two Florida utilities was commingled and was therefore transmitted in interstate commerce, 404 U.S. at 463.

In all of the above cases, the Court's decisions turned on whether energy being transmitted flowed in interstate commerce as a technical matter. The decisions did not turn on whether the transmission of energy flowing in interstate commerce involved energy that was being sold for resale or was being sold to an end user. Thus, there is nothing in the statute, its legislative history, or the case law to indicate that the Commission's jurisdiction over rates, terms and conditions of transmission in interstate commerce extends only to wholesale transmission and not retail transmission. Indeed, the statute on its face gives the Commission jurisdiction over transmission in interstate commerce and makes no distinction between wholesale transmission and retail transmission.

However, there are two important limitations on Commission authority. First, as discussed above, the FPA does not give the Commission jurisdiction over sales of electric energy at retail. Such sales historically have been bundled sales (i.e. generation and transmission), and courts and the Commission have recognized State jurisdiction over bundled sales of energy. Second, under section 201(b)(1) of the FPA, the Commission does not have jurisdiction over facilities used in local distribution. In CL&P, the Court stated that local distribution facilities are exempt from Commission jurisdiction even if those facilities "carry no energy except extra-state energy." 324 U.S. at 531.

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[12] A bus is an electrical conductor which serves as a common connection for two or more electrical circuits. Electric Utility Rate Design Study, Glossary: Electric Utility and Ratemaking Load & Management Terms, Edison Electric Institute (Sept. 11, 1978).

In the next section the Commission further discusses the statutory provisions and case law that shed light on the demarcation between transmission and local distribution, and thus on the jurisdictional line between federal and State authority

II. Legal Analysis of Commission Jurisdictional Transmission Facilities and State Jurisdictional Local Distribution Facilities

Two specific circumstances are addressed:

First, what facilities are jurisdictional to the Commission in a situation involving the unbundled delivery in interstate commerce by a public Utility of electric energy from a third-party supplier to a purchaser who will then resell the energy to an end user?

Second, what facilities are jurisdictional to the Commission in a situation involving the unbundled delivery in interstate commerce by a public utility of electric energy from a third-party supplier to an end user?

Based on an analysis of the relevant legislative history and case law under the FPA, the Commission reaches the following conclusions. With respect to the first circumstance, the Commission concludes that a public utility's facilities used to deliver electric energy to a wholesale purchaser whether labeled "transmission," distribution," or "local distribution" are subject to the Commission's exclusive jurisdiction under sections 205 and 206 of the FPA, and that a public utility's facilities used to deliver electric energy from the wholesale purchaser to the ultimate consumer are "local distribution" facilities subject to the rate jurisdiction of the state.[13]

With respect to the second circumstance, the Commission believes that, based on the particular facts of the case, some of the public utility's facilities used to deliver electric energy to an end-user may be FERC-jurisdictional transmission facilities, while some of the facilities used may be state-jurisdictional local distribution facilities.

We set forth below the relevant legislative history and cast law, our legal conclusion and the factors which we believe are indicative of whether facilities are used in "local distribution" or "transmission in interstate commerce," as those terms are used in the FPA.

1. Relevant Federal Power Act Provisions

The Commission's jurisdiction is set forth in section 201 of the FPA.[14] Section 201(b)(1) provides in pertinent part:

> The provisions of this Part shall apply to the transmission of electric energy in interstate commerce and to the sale of electric

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[13] There are, of course, facilities that are used to provide delivery to both wholesale purchasers and end users. In those situations, we believe that the Commission and the States have jurisdiction to set rates for the services that are within their respective jurisdictions. That facilities are used to serve resale and retail customers does not, however, necessarily mean that the facilities are local distribution facilities.

[14] 16 U.S.C. § 8224.

> energy at wholesale in interstate commerce * * *. The Commission shall have jurisdiction over all facilities for such transmission or sale of electric energy, but shall not have jurisdiction* * *over facilities used in local distribution or only for the transmission of electric energy in intrastate commerce, or over facilities for the transmission of electric energy consumed wholly by the transmitter.[15]

Some of the court decisions that construe jurisdictional facilities under section 201 also construe the Commission's jurisdiction under section 203. Section 203(a) provides, in relevant part:

> No public utility shall sell, lease, or otherwise dispose of the whole of its facilities subject to the jurisdiction of the Commission* * *or by any means whatsoever, directly or indirectly, merge or consolidate such facilities or any part thereof with those of any other person* * *without first having secured an order of the Commission to do so.[16]

In addition, section 206(d) concerns facilities "under the jurisdiction of the Commission":

> The Commission upon its own notion, or upon the request of any State commission whenever it can do so without prejudice to the efficient and proper conduct of its affairs, may investigate and determine the cost of the production or transmission of electric energy by means of facilities under the jurisdiction of the

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[15] 16 U.S.C. § 824e(b) (emphasis added).

[16] 16 U.S.C. §824(b) (emphasis added).

Commission in cases where the Commission has no authority to establish a rate governing the sale of such energy.[17]

2. Legislative History of the FPA

The relevant legislative history of the general purposes of Title II of the FPA, and of section 201 in particular, focuses primarily on bundled sales of electric energy and does not directly address the issue of what constitutes local distribution as opposed to transmission in interstate commerce.

In discussing the general purposes of Title II of the House bill, the House Report states:

> Title II* * *establishes for the first time regulation of electric utility companies transmitting energy in interstate commerce.
>
> * * * * *
>
> * * *Under the decision of the Supreme Court of the United States in (Attleboro), the rates charged in interstate wholesale transactions may not be regulated by the States. Part II gives the Federal Power Commission jurisdiction to regulate these rates. A "wholesale" transaction is defined to mean the sale of electric energy for resale and the Commission is given no jurisdiction over local rates even where the electric energy moves in interstate commerce.[18]

In its analysis of section 201, the House Report states:

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[17] 16 U.S.C. §824e(d) (emphasis added).

[18] H.R. Rep. No. 1318, 74th Cong., 1st Sess. 7-8 (1935).

> As in the Senate bill no jurisdiction is given over local distribution of electric energy, and the authority of States to fix local rates is not disturbed even in those cases where the energy is brought in from another State.[19]

The Senate Report's discussion of the general purposes of the FPA states:

> The decision of the Supreme Court in (Attleboro) placed the interstate wholesale transactions of the electric utilities entirely beyond the reach of the States. Other features of this interstate utility business are equally immune from State control either legally or practically.[20]

In discussing material differences between the final version of the Senate bill and the original version, the Senate Report states:

> Subsection (b), formerly (a), which states the subject matter to which the part relates, has been clarified to make plain that it includes interstate transmission where there is no sale and excludes all facilities used only for production of transmission in intrastate commerce or in local distribution.[21]

In discussing section 201 of the Senate bill, the Senate Report further states:

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[19] *Id.* at p. 27.

[20] S. Rep. No. 621, 74th Cong., 1st Sess. at p. 17 (1935). See id. at p. 18 ("The revision between the original and final versions of the Senate bill) has also removed every encroachment upon the authority of the States. The revised bill would impose Federal regulation only over those matters which cannot effectively be controlled by the States.")

[21] *Id.* at p. 19.

> The rate-making powers of the Commission are confined to those wholesale transactions which the Supreme Court held in (Attleboro) to be beyond the reach of the States. Jurisdiction is asserted also over all interstate transmission lines whether or not there is sale of the energy carried by those lines and over the generating facilities which produce energy for interstate transmission and sale. It is obvious that no steps can be taken to secure the planned coordination of this industry on a regional scale unless all of the facilities, other than those used solely for retail distribution, are made subject to the jurisdiction of the Commission. Facilities used only for intrastate commerce or local distribution are expressly excluded from the operation of the act.[22]

The Conference Report adds little description regarding jurisdictional facilities. In reference to section 201(b) it states that:

> [T]he language of the House amendment has been followed with a clarifying phrase added to remove any doubt as to the Commission's jurisdiction over facilities used for the generation and local distribution of electric energy to the extent provided in other sections of this part and the part next following.[23]

In addition to the above statements pertaining to section 201 of the FPA, Congress referenced distribution of energy in the legislative history of section 206(d). Section 206(d) was originally enacted as section 206(b) of the FPA. Under the

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[22] *Id.* at p. 48. The provisions of the Senate bill regarding federal jurisdiction over generating facilities were eliminated from the final version of the bill.

[23] H.R. Conf. Rep. No. 1903, 74th Cong., 1st Sess. 74 (1935).

Regulatory Fairness Act of 1988,[24] section 206(b) was redesignated as section 206(d).

The Conference Report on the original FPA does not address section 206(b). The Senate Report on the FPA bill states in pertinent part:

> Subsection (b) authorizes the Commission to investigate and determine the cost of the production or transmission to electric energy by means of facilities under the jurisdiction of the Commission in cases where the Commission has no authority to establish a rate governing the sale of such energy.* * * Since the ratemaking powers granted to the Commission apply only to the wholesale rates of energy sold in interstate commerce, this last subsection should be of great benefit in removing the practical difficulty which the States may encounter in regulating the interstate distribution rates which are left under their control. Such rate regulation involves the examination and valuation of property outside the State. The task is one requiring an agency with a jurisdiction broader than that of a single State. The authority of the Federal Commission is to render assistance to the State commissions in a way which would preserve and make more effective the jurisdiction which is thus left to the States.[25]

The House Report discusses section 206(b) as follows:

> This subsection reaches those situations where electric energy is transmitted in interstate commerce by the same company

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[24] Pub. L. No. 100-473, 102 Stat. 2299 (1988).

[25] S. Rep. No. 621, 74th Cong., 1st Sess. 51 (1935) (emphasis added).

which distributes it locally, and will greatly aid State commissions in fixing reasonable rates in such cases.[26]

Thus, the discussions in the two reports do not appear to contemplate a situation in which the transmitter and seller of electric energy are different, and neither is a "local" distributor. The House Report expressly refers to the same company being the transmitter and seller of electric energy. The Senate Report by its terms addresses the regulation of interstate distribution rates.[27]

The above legislative history on sections 201 and 206(b) does not provide any definitive answers to the questions raised. We therefore turn to the case law under the FPA.

3. Case Law Under the FPA

Jersey Central was the first of the major FPC jurisdictional cases considered by the Supreme Court. The case involved the acquisition by New Jersey Power and Light Company (New Jersey Power) of certain securities of Jersey Central Power & Light Company (Jersey Central), without the Commission's prior approval. The question before the Court was whether Jersey Central was a "public utility" under section 201(e)[28] of the FPA

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[26] H.R. Rep. No. 1318, 74th Cong. 1st Sess. 29 (1935) (emphasis added).

[27] The Senate Report states that interstate distribution rates are left in the States' control. Obviously, the Senate drew a distinction between interstate distribution (left in the States' control) and interstate transmission (given to the FPC). Compare S. Rep. No. 621 at p. 49 with H.R. Rep. No. 1318 at p. 51.

[28] Section 201(e) defines a "public utility" as "any person who owns or operates facilities subject to such jurisdiction under this Part (other than facilities subject to such jurisdiction solely by reason of section 210, 211, or 212)." 16 U.S.C. § 824(e). The section adopted in 1935 did not contain the

so that the Commission's prior approval of the stock acquisition was necessary under section 203 of the FPA.

Jersey Central owned transmission facilities that connected to facilities that Public Service Electric & Gas Company (Public Service) owned. The interconnection of these transmission facilities was in New Jersey. Public Service's facilities in turn connected to the facilities of the Staten Island Edison Corporation (Staten Island Edison), a New York utility, at the mid-channel of Kill van Kull, a body of water separating New Jersey and New York. Jersey Central delivered energy to and received energy from Public Service under contract, and Public Service delivered energy to and received energy from Staten Island Edison under contract.[29]

The Court found that, although Jersey Central generated and received electricity only in New Jersey, some of the electric energy that it dispatched to Public Service "was instantaneously transmitted to New York."[30] The Court held that "[t]his evidence * * *furnishes substantial basis for the conclusion of the Commission that facilities of Jersey Central are utilized for the transmission of electric energy across state lines."[31] Therefore, the Court found that Jersey Central was a public utility within the meaning of section 201(e).[32]

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parenthetical, which was adopted in 1978 as part of the Public Utility Regulatory Policies Act.

[29] Jersey Central, 319 U.S. at pp. 63-65.

[30] *Id.* at p. 66.

[31] *Id.* at p. 67 (citation omitted).

[32] *Id.* at p. 73.

The Court cited Attleboro, in which the Court found that the sale of locally produced electric energy for use in another state resulted in the transmission of electric energy in interstate commerce, even though title passed at the state line.[33] In Jersey Central, the Court explained the rationale for federal jurisdiction as follows:

> (Section 201(c) of the FPA) defines the electric energy in commerce as that "transmitted from a State and consumed at any point outside thereof." There was no change in this definition in the various drafts of the bill. The definition was used to "lend precision to the scope of the bill." It is impossible for us to conclude that this definition means less than it says * * *. The purpose of this act was primarily to regulate the rates and charges of the interstate energy. [34]

The Court in Jersey Central thus interpreted the FPA as placing within the federal province regulation of wholesale sales of electric energy that, in any manner, flows in interstate commerce. The language quoted above and the citation to section 201(c) of the FPA, to be relied upon in subsequent Supreme Court cases, strongly suggested that the Commission's jurisdiction was not based on whether there was a sale by the utility, but rather on the flow of electric energy either into or out of a state, so long as the energy crosses state lines.

CL&P, which was decided two years after Jersey Central, is the leading case interpreting the section 201(b) local distribution proviso. In CL&P, the Commission sought to regulate the accounting practices of Connecticut Light & Power Company

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[33] 273 U.S. at pp. 86, 89-90.

[34] 319 U.S. at p. 71 (footnote omitted).

(CL&P).[35] At issue was whether CL&P was a "public utility," under the FPA. The utility's system encompassed an area solely within a single state (Connecticut)[36] and did not interconnect with any other company that operated out of state.[37] "Its purchases and sales, its receipts and deliveries of power, (were) all within the state."[38] However, CL&P did purchase energy from companies that had, in turn, purchased energy from Massachusetts. The company also sold energy to a municipality that exported a portion of that energy to fishers Island, located off the coast of Connecticut but "territory of New York."[39] The Commission based its jurisdiction on these few transactions.[40]

The Court of Appeals affirmed the Commission, holding that the Commission's jurisdiction extended to "electric distribution systems which normally would operate as interstate businesses." The Court of Appeals found that:

> Whether or not the facilities by which petitioner distributes energy from Massachusetts should be classified as 'local' is not relevant to this case. The sole test of jurisdiction of the Commission over accounts is whether these facilities, 'local' or

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[35] CL&P, 324 U.S. at p. 517.

[36] *Id.* at p. 518.

[37] *Id.* at p. 521.

[38] *Id.* at p. 522.

[39] *Id.* at pp. 519-21.

[40] *Id.*

otherwise, are used for the transmission of electric energy from a point in one state to a point in another.(41)

The Supreme Court reversed. It held that the statutory language in Section 201(b) of the FPA providing that the Commission "shall not have jurisdiction * ** over facilities used in local distribution" is a limitation upon Commission jurisdiction that "the Commission must observe and the courts must enforce."[42] In analyzing the statute, the Court stated:

> It has never been questioned that technologically generation, transmission, distribution and consumption are so fused and interdependent that the whole enterprise is within the reach of the commerce power of Congress, either on the basis that it is, or that it affects, interstate commerce if at any point it crosses a state line.
>
> * * * * *
>
> But whatever reason or combination of reasons led Congress to put the provision in the Act, we think it meant what it said by the words "but shall not have jurisdiction* * *over facilities used in local distribution." Congress by these terms plainly was trying to reconcile the Claims of federal and local authorities and to apportion federal and state jurisdiction over the industry.[43]

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[41] *Id.* at p. 522, *quoting Connecticut Light & Power Co. v. FPC*, 141 F.2d 14, 18 (D.C. Cir. 1944).

[42] 324 U.S. at p. 529.

[43] *Id.* at pp. 529-31.

The Court decided that this limitation on jurisdiction was "a legal standard that must be given effect in this case in addition to the technological transmission test."[44]

The Court stated that whether or not local distribution facilities carried out-of-state electric energy was irrelevant. Whatever the origin of the electric energy they carried, so long as the utility used the lines for local distribution,[45] they were exempt from federal jurisdiction.[46] In fact, the Court stated that local distribution facilities "may carry no energy except extra-state energy and still be exempt under the Act." Id. at 531. The Court concluded that the Commission's order:

> Must stand or fall on whether this company owned facilities that were used in transmission of interstate power and which were not facilities used in local distribution.[47]

Upon reversing the Court of Appeals, the Court commented, in dictum, on the evidence the Commission had relied upon in finding that the facilities in question were used for transmission. It noted that the Commission had relied upon certain gas transportation cases in concluding that transmission extends from the generator to the point where the function of conveyance in bulk over distance is completed and the process of subdividing the energy to serve ultimate consumers, which is the characteristic of "local distribution," is begun. The Court cautioned:

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[44] *Id.* at p. 531.

[45] It appears that while the Company received power (at one location) at 66 kV, it primarily owned facilities at 13.8 kV and below.

[46] 324 U.S. at p. 531.

[47] *Id.* at p. 531 (emphasis added).

But a holding that distributing gas at low pressure to consumers is a local business is not a holding that the process of reducing it from high to low pressure is not also part of such local business. In so far as the Commission found in these cases a rule of law which excluded from the business of local distribution the products of reducing energy from high to low voltage in subdividing it to serve ultimate consumers, the Commission has misread the decisions of this Court. No such rule of law has been laid down.[48]

The Court also noted in its dictum, however, that once a company is properly found to be a "public utility" under the Act, the fact that a local commission may also have jurisdiction does not preclude exercise of the Commission's functions. Id. at 533.[49] The Court instructed the lower court to remand the case to the Commission for a finding regarding whether the facilities in question were used in local distribution.[50]

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[48] *Id.* at p. 534.

[49] *See United Stats v. Public Utilities Commission of California*, 345 U.S. 295, 316 (1953) (Public Utilities Commission): Certainly the concrete fact of resale of some portion of the electricity transmitted from a state to a point outside thereof invokes federal jurisdiction at the outset, despite the fact that the power thus used traveled along its interstate route "commingled" with other power sold by the same seller and eventually directly consumed by the same purchaser-distributor.

See also Arkansas Power & Light Co. v. FPC, 368 F.2d 376, 383 (8th Cir. 1966) ("Where a company is in fact a public utility , all wholesale sales for resale in interstate commerce are subject to the provisions of sections 205 and 206 of the (FPA), regardless of the facilities used."). The Eighth Circuit further noted that the section 201(b) exemption applies to a company's status as a public utility and not to the Commission's jurisdiction over sales in interstate commerce for resale. *Id., citing Public Utilities Commission, Colton, infra. and Wisconsin-Michigan, infra.*

[50] *Id.* at p. 536.

The CL&P case was ultimately disposed of without the Commission having made a finding that the facilities were used in local distribution. While the Commission found that it was "extremely doubtful" that it could find that the facilities in question were not local distribution facilities, 6 FPC 104, 106 (1947), the Commission did not articulate a definition of local distribution facilities.

In Wisconsin-Michigan Power Co. v. Federal Power Commission,[51] the Seventh Circuit held that a utility was a jurisdictional public utility where it operated two divisions in Wisconsin and Michigan in a coordinated manner such that electric energy from one state was transmitted to the other, and vice versa, "in appreciable amounts by the power company and by it commingled with energy generated in the two respective districts and then delivered to the [wholesale] customers* * *.[52] The court also rejected the notion that the energy changed its form or character when it was stepped down in voltage before it reached the wholesale purchasers.[53]

The court in Wisconsin-Michigan distinguished between transmission and local distribution by focusing on wholesale sales of electric energy versus retail sales ("local rates") of electric energy. It cited the House Report on the FPA, and characterized the legislative history as follows:

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[51] 197 F.2d 472 (7th Cir. 1952), cert denied, 3345 U.S. 934 (1953) (*Wisconsin-Michigan).*

[52] *Id.* at p. 474.

[53] *Id.* ("Obviously the energy thus transmitted in interstate commerce is not changed in form or in character except that the voltage is reduced to an extent consistent with efficient economic management and operation").

The legislative history, (H.R. Rep. No. 1318). 74th Cong., 1st Sess. pages 7, 8 and 27 (1935), discloses that the Congressional Committee intended that the provisions of the (FPA) should apply to the transmission of electric energy in interstate commerce, i.e., the sale of energy at wholesale in interstate commerce, but not to the retail sale of any such energy in local distribution; that the (FPA) left to the state the authority to fix local rates where the energy is brought in from other states, and that the rate making power of the (FPC) was to be confined to those wholesale transmissions which the Supreme Court had held in (Attleboro) to be beyond the reach of the state. Under that decision, said the committee, the rates charged in interstate wholesale transactions could not be regulated by the states. It defined a wholesale transaction as the sale of electric energy for resale.[54]

The Seventh Circuit's characterization of the House Report seems to equate transmission of electric energy in interstate commerce with the sale of energy at wholesale in interstate commerce. However, this interpretation is at odds with both the plain words of the statute as well as the language of the House Report, both of which refer to transmission in interstate commerce separately from sales for resale in interstate commerce.[55] In addition, the Senate Report, which the Seventh Circuit did not mention, clearly recognized jurisdiction over all

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[54] 197 F.2d at p. 476 (emphasis added).

[55] See H.R. Rep. No. 1318 at p. 27, ("Subsection (b) confers jurisdiction upon the Commission over the transmission of electric energy in interstate commerce and the sale of electric energy in wholesale in interstate commerce * * *." emphasis added.),

interstate transmission lines, whether or not a sale of energy is carried by those lines.[56]

The Wisconsin-Michigan court also cited analogous natural gas cases, stating that "[t]he question is essentially, when does interstate commerce transportation end and where do the local distribution facilities first become operative."[57] The court further stated that:

> (U)pon delivery to (the wholesaler) local distribution begins when he resells. His sales and distribution at retail are clearly local in character, and constitute only local distribution: but at no point before delivery to him has been completed, has interstate transmission terminated. In other words, "facilities used in local distribution" means facilities used for making resale and distribution to consumers, jurisdiction over which is left to the states. It was only because of this conclusion that the Supreme Court said, (citation omitted), the Act "cut(s) sharply and cleanly between sales for resale and direct sales for consumptive uses." We think there is no ground for the position that local distribution includes any transmission occurring before the wholesaler who resells at retail is reached.[58]

The Seventh Circuit concluded that the sales for resale were made in interstate commerce; that local distribution had not begun; that the interstate character of the transmission persisted until delivery to the wholesaler; that, up to that point, no local distribution facilities were in operation and that, therefore, the sales were subject to Commission regulation.

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[56] See S. Rep. No. 621 at p. 48 ("Jurisdiction is asserted over all interstate transmission line whether or not there is a sale of electric energy carried by those lines* * *.).

[57] 197 F.2d at p. 477.

[58] *Id. citing FPC v. East Ohio Gas Co.*, 338 U.S. 464 (1950) (East Ohio).

In Federal Power Commission v. Southern California Edison Company (the Colton case),[59] the Supreme Court held that the FPA provides a clear line of demarcation between jurisdictional transactions and non-jurisdictional transactions. However, this case, too involved bundled sales of electric energy. In the facts of the case, Southern California Edison Company (Edison) admitted that it was a public utility by virtue of owning two interstate transmission lines.[60] At issue was whether its sales of electric energy to the City of Colton, California, for resale to Colton's retail customers, were jurisdictional. Included in the electric energy that Edison sold to Colton was out-of-state electric energy from Hoover Dam.[61] The Commission ruled that the sale to Colton was a sale of electric energy at wholesale in interstate commerce subject to regulation under the FPA.[62] In upholding the Commission, the Court held that Edison's importation of out-of-state electricity for resale to Colton sufficed to confer federal jurisdiction.

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[59] 376 U.S. 205 (1964) (Colton).

[60] The Supreme Court noted that Edison's status as a public utility did not decide the question of whether the FPC could assert jurisdiction over the rates for the Edison-Colton sale, Id. at p.208 n.3.

[61] *Id.* at p. 208, 209 & n.5.

[62] *Id.* app. 208, *See Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission,* 461 U.S. 375, 380 (1983))"(Colton) held, among other things, that * * *a California utility that received some its power from out-of-state was subject to federal and not state regulation in its sales of electricity to a California municipality that resold the bulk of the power to others.").

The Court. citing an earlier Supreme Court case,[63] characterized Congressional intent in the FPA:

> (W)hat Congress did was to adopt the test developed in the Attleboro line which denied state power to regulate a sale "at wholesale to local distributing companies" and allowed state regulation of a sale at "local retail rates to ultimate consumers."[64]

The Court rejected the argument that FPC jurisdiction was confined to those inter-state wholesale sales constitutionally beyond the power of state regulation by force of the Commerce Clause, and was to be determined on a case-by-case analysis of the impact of state regulation upon the national interest. The Court stated that in the FPA:

> (C)ongress meant to draw a bright-line easily ascertained, between state and federal jurisdiction, making unnecessary such case-by-case analysis. This was done in the Power Act by making FPC jurisdiction plenary and extend[ed] it to all wholesale sales in interstate commerce except those which Congress has made explicitly subject to regulation by the States.[65]

The Court held that "(t)here is no such exception covering the Edison-Colton sale."[66]

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[63] *Illinois Natural Gas Co. v. Central Illinois Public Service Co.*, 314 U.S. 498, 504 (1942).

[64] 376 U.S. at p. 214.

[65] *Id.* at pp. 215-216.

[66] *Id.* at p. 216 (footnote omitted).

Parties in the Colton case had raised the question of whether jurisdiction over the Colton sale was prevented by the "local distribution" proviso of section 201 (b). The Court stated that whether facilities are local distribution facilities is a matter for the Commission to decide in the first instance. Citing CL&P, supra, it stated:

> Whether facilities are used in local distribution although a limitation on FPC jurisdiction and a legal standard that must be given effect in addition to the technological transmission test* * * involves a question of fact to be decided by the FPC as an original matter.[67]

The Court cited evidentiary support and the Commission's expertise in such matters in upholding the Commission' determination that certain facilities owned by Edison were used exclusively to effect the wholesale sale to Colton and not for local distribution. Such facilities included 12 kV lines that served an industrial customer, several lighted highway signs, a residence and a railroad section house before they reached the transformers in the Colton substation. The FPC had held that those uses prior to the line reaching the Colton substation did no transform the lines into local distribution facilities.[68]

In Duke Power Company v. Federal Power Commission (Duke),[69] the D.C Circuit held that a public utility's acquisition of facilities used solely in local distribution, and which would continue to be used for local distribution, was beyond the Commission's jurisdiction under section 203. The case involved

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[67] *Id.* at p. 210 n. 6 (citation omitted).

[68] *Id.* at p. 210 n.6.

[69] 401 F.2d 930 (D.C. Cir. 1968) (Duke).

Duke Power Company's (Duke's) proposed acquisition of facilities owned by Clemson University (Clemson), which were used to distribute electricity off-campus to customers (primarily university personnel) in two South Carolina counties. Clemson purchased the power at wholesale from Duke. No one appeared to contest the conclusion that the 7 miles of distribution line and 418 service connections owned by Clemson were "local distribution" facilities.[70] Rather, the case turned on interpreting section 203 and whether it was intended to affect only acquisitions of jurisdictional facilities, or also to affect acquisitions of non-jurisdictional facilities. In interpreting section 203, however, the D.C. Circuit extensively analyzed and discussed the fundamental jurisdictional lines that Congress drew in section 201.

Citing to the CL&P case, the court in Duke stated:

> The Act, as we have seen, effectuated federal control over the transmission and the sale at wholesale of electric energy in interstate commerce, and established the Commission's regulatory power over public utilities engaging in either of these pursuits.[71]

However, quoting CL&P, the court further stated:

> The expression "facilities used in local distribution" is one of relative generality. But as used in this Act it is not a meaningless generality in the light of our history and the structure of our government. We hold the phrase to be a limitation on jurisdiction

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[70] Duke delivered power to Clemson at a distribution voltage of 4,160 volts. The step-down transformers by which the voltage was reduced, and the substations at which the delivery was effected, were owned by Duke, 401 F.2d at p. 931, n.8.

[71] 401 F.2d at pp.938-39 (emphasis added, footnotes omitted).

and a legal standard that must be given effect in this case in addition to the technological transmission test.[72]

The court further rejected the Commission's concept that, in order to determine whether jurisdiction over any particular acquisition existed, the impact of local supervision be measured on a case-by-case basis. Quoting from Colton, the court Stated:

> [T]his "flexible approach"—involving as it does the consideration, inter alia, of "the effect of the regulation upon the national interest in the commerce"—has been flatly-rejected as a technique for resolving jurisdictional conflicts between the Commission and state bodies.* * * We think that like the line "(i)t cut sharply and cleanly between sales for resale and direct sales for consumptive uses" to facilitate jurisdictional determinations in rate regulation. "Congress meant to draw a bright line easily ascertained, between state and federal jurisdiction, making unnecessary such case-by-case analysis." in distributing regulatory power over the acquisition of facilities.[73]

The court rejected the Commission's argument that jurisdiction over the merger or consolidation of jurisdictional facilities with those of any other "person" under section 203 gave the Commission jurisdiction over Duke's acquisition. The court stated that the FPA reflects a policy "' that matters largely of a local nature, even though interstate in character, should be handled locally and should receive the consideration of local (officials) familiar with the local conditions in the communities involved.[74]

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[72] *Id.* (footnote omitted).

[73] *Id* at p. 949 (footnotes omitted).

[74] *Id.* at p. 936 (quoting from Hearings on H.R. 5432 before the House Committee on Interstate and Foreign Commerce, 74th Cong., 1st Sess. 393 (1935) (testimony of then-FPC Commissioner Seavey)).

Federal Power Commission v. Florida Power & Light Company[75] is the last major court case to address the Commission's transmission jurisdiction. In this case, the Commission sought to impose its accounting rules upon Florida Power & Light Company (Florida Power & Light). The company's system lay solely within the borders of Florida and did not directly connect with any out-of-state utility.[76] The Commission held that Florida Power & Light did own facilities that transmitted electric energy in interstate commerce, but the Court of Appeals for the Fifth Circuit ruled that the Commission did not have substantial evidence to support its finding.

The Supreme Court reversed. The Supreme Court noted that Florida Power & Light was a member of the Florida Power Pool along with Florida Power Corporation (Florida Power Corp.).[77] In turn, Florida Power Corp. connected with Georgia Power Company (Georgia Power) at a "bus"[78] south of the Georgia-Florida border.[79] Florida Power Corp. regularly exchanged power with Georgia Power.[80] In many instances, Florida Power Corp. transferred power to Florida Power & Light instantly after receiving power from Georgia Power, and transferred power to Georgia Power immediately after receiving power from Florida Power & Light.[81] The Supreme Court found that power commingled in the bus moved across state lines, and concluded that Florida Power & Light engaged in transmission in interstate commerce. The Court held that to establish jurisdiction, the Commission need only show that "some (Florida Power & Light) power goes out of State."[82] The Court further explained that "(i)f any (Florida Power & Light) power has reached Georgia, or (if Florida Power & Light) makes use of any Georgia power* * *FPC jurisdiction will attach* * *.[83]

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[75] 404 U.S. 453, *reh'g denied,*U.S. 948 (1972) (*Florida Power & Light).*

[76] 404 U.S. at p. 456.

[77] *Id.* at p. 456.

[78] A "bus" is a connector or group of connectors that serves as a common connection for two or more circuit.

[79] 404 U.S. at p. 457.

[80] *Id.*

There is also a line of cases that address, among other things, what constitutes a Commission jurisdictional "sale of electric energy at wholesale"[84] under section 201 of the FPA.[85] These cases all concerned bundled sales. While the issues posed above involve unbundled wheeling, the "resale cases are helpful to the extent they suggest that local distribution takes place only after power is subdivided. See, e.g., 345 U.S. at 316 ("the facilities supplied 'local distribution' only after the current was subdivided for individual consumers.").

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[81] *Id.* at p. 457 & n.8.

[82] *Id.* at p. 461 (emphasis omitted).

[83] *Id.* at p. 461 n. 10, (emphasis added).

[84] See Section 201(d), 16 U.S.C. § 824(d) (1988).

[85] *Public Utilities Commission,* supra note 345: *City of Oakland, California v. FERC,* 754 F.2d 1378 (9th Cir. 1985) (*Oakland*). *See also Alexander v. FERC,* 609 F.@d 543 (D.C. Cir. 1979) (*Alexander*).

4. Natural Gas Act

The Natural Gas Act (NGA) was adopted in 1938. Like the FPA, the NGA contains language limiting the Commission's jurisdiction in situations involving local distribution.[86]

Section 1(b) of the NGA provides:

> The provisions of this Act shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.[87]

There is similarity in many respects between the House and Senate Reports on the FPA and the NGA with respect to the jurisdiction given the Commission. For example, all four reports mention Attleboro as placing interstate wholesale transactions beyond the reach of the States. As indicated in the House Report on the NGA, the States could "regulate sales consumers even though such sales are in interstate commerce, such sales being considered local in character and in the absence of congressional prohibition subject to State regulation." (See H.R. Rep. No. 709, 75th Cong., 1st Sess. 1). However, the House and Senate Reports on the NGA contain identical language not found in the reports on the FPA:

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[86] Courts often rely on cases construing the NGA when interpreting the FPA, and vice versa, *E.g., Arkansas Louisiana Gas Co. v. Hall,* 4453 U.S. 571, 577 n.7 (1981).

[87] 15 U.S.C. § 717(b) (emphasis added).

In view of the importance of section 1(b), which states the scope of the act, it seems advisable to comment on certain provisions appearing therein. It will be noted that this subsection of the bill, after affirmatively stating the matters to which the act is to apply, contains a provision specifying what the act is not to apply to, as follows:

> But shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.
>
> The quoted words are not actually necessary, as the matters specified therein could not be said fairly to be covered by the language affirmatively stating the jurisdiction of the Commission, but similar language was in previous bills, and, rather than invite the contention, however unfounded, that the elimination of the negative language would broaden the scope of the act, the committee has included it in this bill. That part of the negative declaration stating that the act shall not apply to "the local distribution of natural gas" is surplusage by reason of the fact that distribution is made only to consumers in connection with sales, and since no jurisdiction is given to the Commission to regulate sales to consumers the Commission would have no authority over distribution, whether or not local in character. (Emphasis added).[88]

As a result of this language it can be argued that Congress considered distribution (and local distribution) only in the context of bundled retail sales of natural gas. In fact, it appears that all of the court cases affirming the states' right to regulate local distribution of gas have involved bundled retail sales. See

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[88] H.R. Rep. No. 709, 75th Cong., 1st Sess. 37 (1937): S. Rep. No. 1162, 75th Cong., 1st Sess. 3 (1937).

Panhandle Eastern Pipe Line Co. v. Michigan Public Service Commission, 341 U.S. 329 (1951) (Panhandle). There the Court, in affirming the State of Michigan's right to regulate an interstate pipeline's proposed bundled retail sales of gas to industrial consumers, noted that the pipeline company proposed to lay pipeline in "the streets and alleys of Detroit" and ignored the local distribution company's request for additional gas to meet the increased needs of the industrial consumers. Id. at 333. While the Court based its holding on a state's authority to regulate direct (retail) sales to an end-user, rather than on the basis of the section l(b) local distribution provision, it also found that the proposed sales were "primarily of local interest" and "emphasized the need for local regulation." Id. Two years before Panhandle, the Supreme Court issued its decision in FPC v. East Ohio Gas Co., 338 U.S. 465 (1949) (East Ohio). East Ohio Gas Company owned and operated a natural gas business wholly within the State of Ohio. The company sold gas only to Ohio customers but most of the gas was transported to Ohio from other states by interstate pipelines. These interstate pipelines connected inside Ohio with East Ohio's large high pressure lines. The gas then was transported over 100 miles through East Ohio's system to its local distribution system. East Ohio argued that it was exempt from Commission jurisdiction because all of its facilities were local distribution.

The Court disagreed, finding the Commission's jurisdiction extends over the transportation of gas in interstate commerce through high-pressure transmission lines and that distribution did not begin until the point where pressure is reduced and gas enters local mains. The Court stated that: "[w]hat Congress must have meant by 'facilities' for 'local distribution' was equipment for distributing gas among customers within a particular local community, not the high-pressure pipelines transporting the gas to the local mains.'"[89]

The Commission relied in part on East Ohio's high pressure/low pressure distinction in a recent NGA section 7 certificate case which authorized construction of facilities to bypass the local distribution company.[90] On appeal, the California Commission argued that under section l(b) it should at least have "jurisdiction over the 'taps, meters and other tie-in facilities' that link the pipeline to end users.'"[91] The court disagreed:

> While as a matter of ordinary English 'local distribution' might be understood to encompass any delivery to an end user, that is hardly the only or even more plausible reading. Distribution conjures up receiving a large quantity of some good and parcelling it out among many takers.[92]

After reviewing the report language discussed above, the court also stated:

> Insofar as congressional committees spoke to the matter * * * they appear to have viewed distribution as confined to its

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[89] 338 U.S. at pp 469-70.

[90] *See Mojave Pipeline Company*, 35 FERC ¶ 61,199 (1986), *reh'g denied*, 41 FERC ¶ 61,040 (1987), *reh'g denied*, 42 FERC ¶ 61,351 (1988): *see also Mojave Pipeline Company*, 66 FERC ¶ 61,194 (1994), *reh'g pending*.

[91] *See Public Utilities Commission of the State of California v. FERC, et al.*, 900 F.2d 269, 273 (D.C. Cir. 1990) (footnote omitted) (*WyCal*).

[92] *Id.* at p. 276.

> parcelling out function and (probably) even more narrowly, to parcelling out accompanied by retail sales.[93]

In Cascade Natural Gas Corporation v. FERC, et al. (Cascade), the court affirmed the Commission's authorizing an interstate pipeline under section 7 of the NGA "to construct a tap and meter facility that would allow it to deliver natural gas directly to two industrial consumers* * *'"[94] To reach the interstate pipeline, the industrials constructed a nine mile pipeline. Together, the facilities by-passed the local distribution company.[95]

The court rejected arguments that section 1(b) deprived the Commission of jurisdiction holding that:

> "Local distribution." as Congress viewed the term, involves two components: the retail sale of natural gas and its local delivery, normally through a network of branch lines designed to supply local consumers.[96]

5. Analysis

a. What facilities are jurisdictional to the Commission in a situation involving the unbundled delivery in interstate commerce by a public utility of electric energy from a third-party supplier to a purchaser who will then re-sell the energy to an end user?

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[93] *Id.* (emphasis in original).

[94] 955 F.2d 1412, 1414 (10th Cir. 1992).

[95] Unlike the situation in WyCal where the pipeline made direct sales to end users, in *Cascade*, the pipeline transported gas purchased from third parties. *See Northwest Pipeline Corporation*, 51 FERC ¶ 61,289 at p. 61,909 (1990).

[96] Cascade, 955 F.2d at p. 1421.

The case law supports the conclusion that any facilities of a public utility used to deliver electric energy in interstate commerce to a wholesale purchaser, whether such facilities are labeled "transmission," "distribution" or "local distribution," are subject to the Commission's jurisdiction under sections 205 and 206.

This conclusion is supported by Public Utilities Commission, supra, in which the Supreme Court, in the section of its opinion addressing the section 201(b) local distribution provision, held that local distribution facilities began "only after the current was subdivided for individual consumers."[97] Wisconsin-Michigan. supra, in which the Seventh Circuit held that there is no local distribution until the wholesaler who re-sells at retail is reached, is to like effect.

This conclusion, which results in a "functional" line being drawn to determine Commission jurisdiction, is not only consistent with the case law under section 201, but is also consistent with our interpretation of the line drawn under newly amended FPA sections 211 and 212. As long as electric energy is being sold to a legitimate wholesale purchaser, we believe the Commission has jurisdiction under sections 201, 205, and 206 of the FPA over the public utility's facilities used to deliver electric energy to that purchaser.

b. What facilities are jurisdictional to the Commission in a situation involving the unbundled delivery in interstate commerce by a public utility of electric energy from a third-party supplier directly to an end user?

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[97] 345 U.S. at p. 316 (footnote omitted).

In analyzing jurisdiction over unbundled retail wheeling, we believe it is important to distinguish between unbundled wheeling provided by the public utility who previously provided bundled retail service to the end user, and unbundled wheeling provided by other public utilities to the end user. For example, a former bundled retail customer may need unbundled wheeling services from its previous public utility generation supplier, as well as unbundled wheeling from one or more intervening public utilities, in order to reach a distant generation supplier. In this scenario, the Commission believes it would have jurisdiction over all of the facilities used for the unbundled wheeling provided by the intervening public utilities.[98] The more difficult issue is whether some portion of the facilities used to transmit energy from the transmitting utility in closest proximity to the end user (the former supplier of the bundled product) is local distribution facilities. We believe that in most, if not all circumstances, some portion will be local distribution facilities.

The case law is replete with statements that the local distribution provision of section 201 must be given effect. However, the Supreme Court in both CL&P and Colton, supra, has stated that whether facilities are used in local distribution is a question of fact to be decided by the Commission as an original matter. Thus, there is no clear case law on a "bright line" between transmission and local distribution. In addition, regardless of the details of the chain of delivery services necessary to move electric energy from the generator to the end user, in most cases the last public utility in the chain will use facilities that historically were considered local distribution facilities. Accordingly, unlike the situation involving unbundled wholesale wheeling, for which the case law clearly supports a "functional" test, the Commission believes the case law and practical realities of a changing industry support an analysis of local distribution facilities based on the facilities' functional as well as technical characteristics.

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[98] The Commission would not have jurisdiction over the rates for the sale of generation by the distant supplier because the transaction would be a retail sale of electric energy.

While it would be preferable to draw an absolutely "bright" line (e.g.. based on technical characteristics such as voltage), the Commission does not believe this is required by the case law and, importantly, would not be a workable approach in all cases because of the variety of circumstances that may arise and because utilities themselves classify facilities differently (e.g., one utility may classify a 69 kV facility as transmission; another may classify it as distribution).

Therefore, the Commission is adopting several indicators it will evaluate in determining whether particular facilities are transmission or local distribution in the case of vertically integrated transmission and distribution utilities:[99]

- Local distribution facilities are normally in close proximity to retail customers.

- Local distribution facilities are primarily radial in character.

- Power flows into local distribution systems, it rarely, if ever, flows out.

- When Power enters a local distribution system, it is not reconsigned or transported on to some other market.

- Power entering a local distribution system is consumed in a comparatively restricted geographical area.

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[99] In the case of a distribution-only utility, which is franchised by a State of local government and sells only at retail, all of the circuits (and related wires, transformers, towers, and rights of way) which it owns or operates (regardless of voltage) would be local distribution facilities.

- Meters are based at the transmission/local distribution interface to measure flows into the local distribution system.

- Local distribution systems will be of reduced voltage.[100]

In summary for unbundled wholesale wheeling the Commission will apply a functional test. The only definitive question will be whether the entity to whom the power is delivered is a lawful wholesaler. For unbundled retail wheeling the Commission will apply a combination functional- technical test that will take into account technical characteristics of the facilities used for the wheeling. The Commission concludes that these tests are consistent with the FPA, its legislative history and the case law discussed above.

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[100] The Commission has analyzed utilities' filings required by the Commission's regulations. These filings are made on FERC Form No. 1. While there is no uniform breakpoint between transmission and distribution, it appears that utilities account for facilities operated at greater than 30 kV as transmission and that distribution facilities are usually less than 40 kV.

APPENDIX E

Section 31,048 Federal Energy Regulatory Commission Regulations Preambles (Order 888-A)

[¶ 31,048]

62 F.R. 12274 (March 14, 1997)
18 C.F.R. Part 35
[Docket Nos. RM95-8-001 and RM94-7-002; Order No. 888-A)

Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities

(Issued March 4, 1997)
AGENCY: Federal Energy Regulatory Commission.

ACTION: Final rules; order on rehearing.

SUMMARY: The Federal Energy Regulatory Commission. (Commission) reaffirms its basic determinations in Order No. 888 and clarifies certain terms. Order No. 888 requires all public utilities that own, control or operate facilities used for transmitting electric energy in interstate commerce to have on file open-access non-discriminatory transmission tariffs that contain minimum terms and conditions of non-discriminatory service. Order No. 888 also permits public utilities and transmitting utilities to seek recovery of legitimate, prudent and verifiable stranded costs associated with providing open-access and Federal Power Act section 211 transmission services. The Commission's goal is to remove impediments to competition in the wholesale bulk power marketplace and to bring more efficient, lower cost power to the Nation's electricity consumers.

EFFECTIVE DATE: Changes to Order No. 888 made in this order on rehearing will become effective on [insert date 60 days after date of publication in the Federal Register].

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SUPPLEMENTARY INFORMATION: In addition to publishing the full text of this document in the Federal Register, the Commission also provides all interested persons an opportunity to inspect or copy the contents of this document during normal business hours in the Public Reference Room at 888 First Street, N.E., Washington, D.C. 20426.

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Finally, the complete text on diskette in WordPerfect format may be purchased from the Commissioner's copy contractor, La Dorn Systems Corporation. La Dorn Systems Corporation is also located in the Public Reference Room at 888 First Street, N.E., Washington, D.C. 20426.

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I. Introduction and Summary

On April 24, 1996, the Commission issued Final Rules (Order Nos. 888 *(FERC Statues and Regulations, Regulations Preambles January 1991-June 1996* ¶31,036) and 889 *(FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* ¶31,035) intended to remedy undue discrimination in the provision of interstate transmission services by public utilities and to address the stranded costs that may result from the

transition to more competitive electricity markets.[1] At the heart of these rules is a requirement that prohibits owners and operators of monopoly transmission facilities from denying transmission access, or offering only inferior access, to other power suppliers in order to favor the monopolists' own generation and increase monopoly profits—at the expense of the nation's electricity consumers and the economy as a whole.

The electric utility industry today is not the industry of ten years ago, or even five years ago. While historically it was assumed that local utilities would be the only ones to generate and transmit power for their customers, today there is a broad array of potential competitors to supply power and widespread transmission facilities that can carry power vast distances. But competitors cannot reach customers if they cannot have fair access to the transmission wires necessary to reach those customers. It is against this industry backdrop that the Commission in Order No. 888 exercised its public interest responsibilities pursuant to sections 205 and 206 of the Federal Power Act (FPA), to reexamine undue discrimination in interstate transmission services and the effect of that discrimination on the electricity customers whom we are bound to protect under the FPA.

We here affirm the legal and policy bases on which Order No. 888 is grounded. Utility practices that were acceptable in past years, if permitted to continue, will smother the fledgling competition in electricity markets and undermine the national policies reflected in the Energy Policy Act of 1992 to encourage the development of competitive markets. We firmly believe that our authorities under the FPA not only permit us to adapt to changing economic realities in the electric industry, but also require us to do so, as necessary to eliminate undue discrimination and protect electricity customers. The record supports our conclusion that, absent open access, undue discrimination will continue to be a fact of life in today's and tomorrow's electric power markets. As recent events clearly demonstrate, unbundled electric transmission service will be the centerpiece of a freely traded commodity market in electricity in which wholesale customers can shop for competitively-priced power.

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[1] Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Order No. 888, 61 FR 21,540 (May 10, 1996), *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* ¶31,036, clarified, 76 FERC ¶61,009 and 76 FERC ¶61,347 (1996). Order No. 889 *(FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* ¶31,035) is an accompanying rule and specific rehearing arguments on that rule will be addressed separately.

The only way to effectuate competitive markets and remedy discrimination is through readily available, non-discriminatory transmission access. The Commission estimates the potential quantitative benefits from such access will be approximately $3.8 to $5.4 billion per year in cost savings, in addition to the non-quantifiable benefits that include better use of existing assets and institutions, new market mechanisms, technical innovation, and less rate distortion.

Order No. 888 has two central components. The first requires all public utilities that own, operate or control interstate transmission facilities to offer network and point-to-point transmission services (and ancillary services) to all eligible buyers and sellers in wholesale bulk power markets, and to take transmission service for their own use under the same rates, terms and conditions offered to others. In other words, it requires non-discriminatory (comparable) treatment for all eligible users of the monopolists' transmission facilities. The non-discriminatory services required by Order No. 888, known as open-access services, are reflected in a *pro forma* open-access tariff contained in the Rule. The rule also requires functional separation of the utilities' transmission and power marketing functions (also referred to as functional unbundling) and the adoption of an electric transmission system information network.

The second central component of Order No. 888 was to address whether and how utilities will be able to recover costs that could become stranded when wholesale customers use the open-access tariffs, or FPA section 211 tariffs,[2] to leave their utilities' power supply systems and shop for power elsewhere. Because of competitive changes occurring at the retail level, as numerous states have begun retail transmission access programs, Order No. 888 also clarifies whether and when the Commission may address stranded costs caused by retail wheeling and the extent of the Commission's jurisdiction over unbundled retail transmission. The Commission further addresses the circumstances under which utilities and their wholesale customers may seek to modify contracts made under the old regulatory regime, taking into account the goals of reasonably accelerating customers' ability to benefit from competitively priced power and at the same time ensuring the financial stability of electric utilities during the transition to competition.

137 entities filed requests for rehearing and/or clarification of Order No. 888. While these parties raise a variety of arguments—including legal, policy, and technical arguments—the majority (including a majority of public utilities) agree that we need to harness the benefits that competitive electricity markets can bring to the nation. The disagreements primarily focus on the mechanics of how we should do this, who should

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[2] Under section 211 of the FPA, the commission, on a case-by-case basis upon application by an eligible customer, may order both public utilities and non-public utilities that own or operate transmission facilities used for the sale of electric energy at wholesale to provide transmission services to the applicant if it finds it is in the public interest to issue such order.

pay the costs of the transition to competition, and how long the transition should take.

First, parties disagree on what is necessary to remedy undue discrimination and to develop truly competitive wholesale markets. Many focus specifically on the tariff terms and conditions of good transmission access and seek changes in the Order No. 888 *pro forma* tariff. In response to these types of rehearing arguments, the Commission has fine-tuned or changed some of the *pro forma* tariff terms and conditions to better ensure that they do not permit discrimination and that they result in well-functioning markets. Other petitioners focus on additional structural changes which they believe are necessary, such as mandatory corporate restructuring (divestiture of generation assets) or mandatory creation of independent transmission system operators (ISOs). With regard to restructuring, the Commission continues to believe that functional unbundling of the utility's business, not corporate divestiture or mandatory ISOs, is sufficient to remedy undue discrimination at this time.

The most contentious arguments raised on rehearing involve how we deal with the transition costs associated with moving to competition. Some utilities have invested millions of dollars in facilities and purchased power contracts based on an explicit or implicit obligation to serve customers and the expectation that those customers would remain on their systems for the foreseeable future. These utilities face so-called "stranded costs" which, if not recovered from the customers that caused the costs to be incurred, could be shifted to other customers.

There are two basic categories of rehearing arguments regarding stranded cost recovery. Most utilities want a guarantee from this Commission that they will recover all stranded costs, whether caused by losing retail customers or wholesale customers. Many customers, on the other hand, want to be able to abrogate existing power supply contracts so that they can immediately leave their current suppliers' systems and shop for cheaper power elsewhere, without paying the sunk costs that their suppliers incurred on their behalf.

In response to these diverse arguments, the Commission has struck a reasonable balance that, for certain defined circumstances, permits utilities the opportunity to seek extra-contractual recovery of stranded costs from their departing customers and permits customers the opportunity to make a showing that their contracts should be shortened or terminated. Based on our experience in the natural gas area, we have learned that it is critical to address these issues early, but we also have chose an approach different from that taken in the gas area because of the different circumstances facing the electric industry.

In balancing the wide array of interests reflected in the rehearing petitions, we have made a number of clarifications and granted rehearing on some issues, but we reaffirm the core elements and framework of Order No. 888. Since the time the final rules issued, as discussed in section III, the pace of competitive change has continued to escalate in the industry at both the wholesale and retail levels as competitors, customers and state regulatory authorities aggressively seek ways to lower the price of electricity. We therefore believe it is all the more critical that we remedy undue discrimination in interstate transmission services now, and that we do so generically, if we are to fulfill our responsibilities under the FPA to protect consumers and provide fair and orderly transition to new competitive markets.

Finally, with respect to environmental issues associated with this rulemaking, certain parties on rehearing continue to challenge the adequacy of our Final Environmental Impact Statement (FEIS). The central issues are whether the Final Rule will increase emissions or nitrogen oxides (NO_x) from certain fossil-fuel fired generators, while could affect air quality in downwind areas to which these emissions may be carried, and the Commission's authority to mitigate environmental consequences.

We deny rehearing on the environmental issues raised and affirm our conclusion that we have satisfied our obligations under NEPA. As discussed in detail in the Final Rule, this rulemaking is expected to slightly increase or slightly decrease total future No_x emissions, depending on whether competitive conditions in the electric industry favor the utilization of natural gas or coal as a fuel for the generation of electricity. We also examined mitigation options over the longer term, and found that the preferred approach for mitigating any adverse environmental consequences would be for the Environmental Protection Agency (EPA) and the states to address the problem through regulatory authorities available under the Clean Air Act. The petitions for rehearing have not persuaded us to change this approach. Indeed, we note that since the issuance of Order No. 888, the EPA has concluded that the rule is unlikely to have any immediate significant adverse environmental impact and thus concurred that the Commission's analysis is adequate under NEPA. We further note that EPA has recently taken steps under the Clean Air Act to address NO/x/ emissions as part of a comprehensive emissions control program, along the lines endorsed by the Commission in the EIS.

In summary, the Commission believes that our authorities under the FPA not only permit us to adapt to changing economic realities in the electric industry, but also requires us to do so to eliminate undue discrimination and protect electricity customers. The measures required in Order No. 888 are necessary to remedy undue discrimination in interstate transmission services and provide an orderly and fair transition to competitive bulk power markets.

To assist the reader, we provide below a section-by-section summary of key elements of this Order on Rehearing.

Scope of the Rule

In this section we discuss petitions to rehear our requirement that transmission and power sales services be contracted for separately (unbundled). We affirm that this requirement is a reasonable and workable means of assuring non-discriminatory open-access transmission. In doing so we refuse invitations to require that utilities under our jurisdiction divest themselves of generation or transmission assets. We do, however, make an important clarification involving how we will deal with existing contracts that contain so-called *Mobile-Sierra* clauses (clauses under which one or both parties agreed not to seek modification of contract terms unless they could show that it is contrary to the public interest not to permit the modification).

In Order No. 888 we concluded that contracts would not be abrogated by operation of the Rule. Instead, preexisting contracts would continue to be honored until such time as they were revised or terminated. We also found that those who were operating under pre-existing requirements contracts containing *Mobile-Sierra* clauses would nonetheless be allowed to seek reform of the contracts on a case-by-case basis. On rehearing we affirm that public utilities will be allowed to file to amend their *Mobile-Sierra* contracts for the limited purpose of providing an opportunity to seek recovery of stranded costs, without having to make a public interest showing that such cost recovery should be permitted. However, these utilities will have the burden, on a case-by-case basis, of showing that they had a reasonable expectation of continuing to serve the departing customer after the contract term. We clarify that if the utilities under such contracts seek to modify provisions that do not relate to stranded costs, they will have the burden of showing that the provisions are contrary to the public interest.

We here make clear that, in turn, customers will be allowed to file to maned their *Mobile-Sierra* conflicts to modify any contract term or to terminate the contract, without having to make a showing that the contract terms are contrary to the public interest. Instead, customers seeking modifications must demonstrate that the provisions they wish modified are no longer "just and reasonable." We affirm our conclusion in the Final Rule that if a customer seeks to shorten or eliminate the term of its contract, however, any contract modification approved by the Commission will provide for appropriate stranded cost recovery by the customer's supplying utility.

These various provisions meet the twofold need to deal with stranded costs and the contracts under which those costs were incurred. However, as described in Order No. 888, the opportunity to reform *Mobile-Sierra* contracts extends only to a limited set of contracts—those entered into on or before July 11, 1994, for requirements power.

Comparability

In this section we deal with those requesting rehearing of our conclusions regarding what "comparable" service is, who is eligible for that service, and how it is to be implemented. We affirm our finding that, as a matter of law, we have jurisdiction over the rates, terms and conditions of unbundled transmission service provided to retail customers. We also clarify that we have authority to order "indirect" unbundled retail transmission services and that if such transmission is ordered by us in the future, or if it is provided voluntarily, otherwise eligible customers may obtain such service under the open-access tariff. We expect public utilities to provide such service in the future and, if they do not, we will not hesitate to order it.

We modify in two respects the definition of who is eligible for open-access transmission service. First, we clarify that, with respect to service that this Commission is prohibited from ordering by section 212(h) of the Federal Power Act (retail wheeling directly to an ultimate consumer and "sham" wholesale wheeling), entities are eligible for such service under the tariff only if it is provided pursuant to a state requirement or is provided voluntarily. Second, we clarify that retail customers taking unbundled service pursuant to a state requirement (i.e., direct retail service) are eligible for such service only from those transmission providers that the state orders to provide service. These changes are made to make clear that our rules cannot be used to circumvent the proscriptions placed on the Commission against ordering direct retail wheeling.

Ancillary Services

In this section we deal with petitions to rehear our definitions of ancillary services—those services such as scheduling, voltage control, and supplemental reserve service that must or can attend the providing of transmission service—as well as the provisions involving these services. We reaffirm that tariffs must separately state the charges for these services. We do modify some of the definitions of these services to conform to industry needs and practices. Most importantly, we make clear that the transmission provider's sale of ancillary services associated with providing basic transmission service is not a wholesale merchant function and thus does not violate the standards of conduct imposed with Order No. 889.

Coordination Arrangements

The requirement to provide non-discriminatory open-access transmission applies to any agreement between utilities that contains transmission rates, terms or conditions. This includes pooling arrangements and agreements between companies contracting to provide each other mutually beneficial transmission services. In Order No. 888 we laid out rules under which the open-access comparability requirements would apply to tight and loose power pools, public utility holding companies and bilateral coordination agreements. We also set out principles that would govern our approval of independent system operator (ISO) agreements.

In this section we affirm the rules governing coordination agreements. In doing so we clarify the definition of "loose pool." we also make clear that, unlike in other situations where we require utilities to provide not only the services they provide themselves but those they could provide themselves, we will require members of loose pools to offer to third parties only those transmission services that they provide themselves under their pool-wide agreements.

We also reaffirm our strong commitment to the concept of ISOs and the ISO principles described in Order No. 888. In doing se we reject arguments that we should require that ISOs be formed. At the same time, we emphasize that while there is no "cookie-cutter" approach to forming an acceptable ISO, the requirement of fair and non-discriminatory rules of governance (Principle One) and the requirement that ISO employees have no financial interest in the economic interests of power marketers—backed by strict conflict of interest provisions—(Principle Two) are fundamental to our approving any ISO.

Pro Forma Tariff Provisions

The *pro forma* tariff is the basic mechanism implementing the requirements of comparable open-access transmission. It provides the details of the transmission service obligations imposed on jurisdictional utilities by the Rule. On rehearing we affirm most of the provisions set out in Order No. 888 for the *pro forma* tariff. We do make changes to conform the *pro forma* tariff to changes adopted under other sections (for example, the definition of "eligible customer").

The rehearing petitions raised many questions about how particular aspects of the tariff will work. For the most part, these questions cannot be answered generically, but must be resolved on a case-by-case basis in the context of specific fact situations. However, the petitions brought to light issues that require clarifications and in some cases revisions to the tariff. The most significant of these involve discounting practices, provisions governing priority of service and curtailment, and the reciprocity provision.

Discounting practices. Originally, we provided different rules depending upon whether the transmission provider was offering a discount to itself or an affiliate or offering a discount to a non-affiliate. In response to the rehearing petitions, we are making three significant changes to the discounting requirements to better permit the ready identification of discriminatory discounting practices while also providing greater discount flexibility.

First, any discount offered on transmission services (including supporting ancillary services) by a transmission provider or requested by any customer must now be made only over the OASIS. With this change, all will have the same, timely access to discounted services. In making this change, we clarify that a transmission provider may limit its discounted service to particular time periods.

Second, once the provider and customer agree on a discount, the details on the discounted service—the price, points of receipt and delivery, and length of service—must be immediately posted on the OASIS.

Third, we revise our rule respecting what other transmission paths must be offered at a discount. Originally, in Order No. 888, we required that when a discount was offered over one path, the transmission provider would have to provide that discount over all other unconstrained paths on its system. We will no longer require this. Instead, the discount will be limited to those unconstrained paths that go to the same point(s) of delivery as the discounted service being provided on the transmission provider's system. The discount will extend for the same time period and must be offered to all transmission service customers.

Priority and Curtailment. We affirm the right of first refusal policy that reservation priority continues for firm service customers served under a contract of one year or more. We also affirm that curtailment must be made on a pro-rata basis and clarify that non-firm point-to-point service is subordinate to firm service. However, we clarify that the pro-rata curtailment requirement extends to only those transactions that alleviate the constraint.

Reciprocity. In Order No. 888 we conditioned the use of a public utility's open-access service on the agreement that, in return, it is offered reciprocal service by non-public utilities that own or control transmission facilities. Such reciprocal service does not have to be through an open-access tariff, i.e., a tariff available to all eligible customers, but may be limited to those public utilities from whom the non-public utility obtains open-access service. We affirm the reciprocity condition. In doing so, however, we make several clarifications.

First, a public utility is free to offer transmission service to a non-public utility without requiring reciprocal service in return. In other words, it may voluntarily waive the reciprocity condition. However, if it chooses to do so, transmission service must be provided through the *pro forma* tariff. Alternatively, bilateral agreements for transmission service provided by the public utility will not be permitted.

Second, we clarify that under the reciprocity condition a non-public utility must agree to offer the Transmission Provider any transmission service the non-public utility provides or is capable of providing on its system. This means that the non-public utility undertaking reciprocity must have an OASIS and must operate under the standards of conduct imposed under Order No. 889 unless it is granted a waiver by the Commission or, where appropriate, by a regional transmission group (RTG) of which it is a member. We also clarify that a non-public utility cannot avoid its responsibilities by obtaining transmission service through other transmission customers. Further, the seller as well as the buyer in the chain of a transaction involving a non-public utility will have to comply with the reciprocity condition.

Third, we adhere to our decision not to treat generation and transmission (G&T) cooperatives and their member distribution cooperatives as a single unit. Thus, the reciprocity provision extends to the G&T Cooperative and not to its member distribution cooperatives.

Fourth, we clarify the "safe harbor" provision under which a non-public utility may get a Commission decision that its transmission tariff suffices to meet reciprocity. A non-public utility may limit the use of any reciprocity tariff that it voluntarily files at the Commission to those transmission providers from whom the non-public utility obtains open-access service. A non-public utility also may satisfy reciprocity through bilateral agreements with a public utility. As a related matter, if a public utility believes a non-public utility is violating the reciprocity condition, it may file with the Commission a petition to terminate its service to the non-public utility.

Fifth, we clarify that non-public utilities may include stranded cost provisions in their reciprocity tariffs.

Sixth, the order on rehearing removes the term "interstate" from the reciprocity provisions. This is to make clear that reciprocity applies even to those who do not own or control interstate transmission facilities, i.e., foreign utilities and those located in the ERCOT region of Texas.

As to local furnishing bonds held by some public utilities, we clarify that all costs associated with the loss of tax-exempt status of those bonds caused by providing open-access transmission service are properly considered costs of providing that service. This includes costs of defeasing, redeeming, and refinancing those bonds.

Other Clarifications. In this order on rehearing we take the opportunity to clarify various other tariff provisions. Among these: Transmission providers do not have to take service under the open-access tariff for transmitting power purchased on behalf of their bundled retail customers. Also, the ability to reserve capacity to meet the reliability needs of a transmission provider's native load applies equally to present transmission and transmission that is built on the future.

Implementation

On rehearing, we make no substantive changes to the implementation provisions originally required under Order No. 888. For the most part, the implementation process has been completed. Utilities have made the requisite tariff and compliance filings and public and non-public utilities have, through other orders, been provided guidance as to obtaining waivers of Order No. 888 and Order No. 889 requirements.

We emphasize that we do not require the abrogation of existing contracts. Rather, the Rule requires only that transmission providers offer transmission under the open-access tariff in addition to existing service obligations. Commitments made under existing contracts will continue. Of course, both transmission providers and their customers may seek to revise the terms and conditions of existing contracts by making the necessary filings as appropriate, under sections 205 and 206 of the Federal Power Act.

State and Federal Jurisdiction

On rehearing we reaffirm our decision that when transmission services is provided to serve retail customers apart from any contract for the retail sale of power, i.e., when it is provided on an unbundled basis, that transmission service is under our jurisdiction. In today's market, and increasingly in the future as more states adopt retail wheeling programs, retail transactions are, and will be, broken down into products that are sold separately—transmission and generation—and sold by different entities. The exercise of our jurisdiction over the rates, terms and conditions of unbundled retail transmission will, therefore, become more important. We also recognize that states have jurisdiction over facilities used for local distribution.

On rehearing, we also reaffirm the seven-factor test of Order No. 888 to distinguish transmission under our jurisdiction from state-jurisdictional local distribution. In doing so, we recognize that our test does not resolve all possible issues. There may be other factors that should be taken into account. The test, therefore, is designed for flexibility to include unique local characteristics and usages. To that end, we will continue to defer to state findings on these matters.

In addition, we clarify that states have the authority to determine the retail marketing areas of the electric utilities within their respective jurisdictions. We also recognize that states have the concomitant authority to determine the end-user services these utilities provide.

Stranded Costs

On rehearing, we reaffirm our basic decisions surrounding the recovery of stranded costs. Utilities will be allowed the opportunity to seek to recover legitimate, prudent, and verifiable wholesale stranded costs. This opportunity is limited to costs associated with serving customers under wholesale requirements contracts executed on or before July 11, 1994 that do not contain explicit stranded cost provisions; and costs associated with serving retail-turned-wholesale customers.

We clarify that we will consider on a case-by-case basis whether to treat a contract extended or renegotiated without a stranded cost provision as an existing contract for stranded cost purposes.

In each case, the opportunity to seek stranded costs is limited to situations in which there is a direct nexus between the availability and use of a Commission-required transmission tariff and the stranding of the costs. The Rule does not allow the recovery of costs that do not arise from the new, accelerated availability of non-discriminatory transmission access.

The Commission also reaffirms its decision that stranded costs should be recovered from the customer that caused the costs to be incurred. The Commission is not requiring other remaining customers, or the utility, to shoulder a portion of its stranded costs that meet the requirements for recovery.

The Commission, as described in Order No. 888, will be the primary forum for addressing the recovery of stranded costs caused by retail-turned-wholesale customers. With respect to such cases, we have made several changes.

First, the Commission has reconsidered its decision respecting cases involving existing municipal utilities that annex retail customer service territories. Under Order No. 888, we found that in such cases the Commission should not be the primary forum for determining stranded cost recovery. On rehearing we now find that such cases should fall within our province.

Second, we clarify that the opportunity for recovery of stranded costs associated with retail-turned-wholesale customers applies regardless of whether the customer or its new supplier is the one requesting and contracting for the transmission service. To this end, we have revised the definition of "wholesale stranded cost."

With respect to the recovery of stranded costs caused by unbundled retail wheeling, we affirm that the only circumstance in which we will entertain requests for these types of costs is when the state regulatory authority does not have authority under state law to address stranded costs when the retail wheeling is required. We clarify that if a state regulatory authority has in fact addressed such costs, regardless of whether it has allowed full recovery, partial recovery or no recovery, utilities may not apply to the Commission to recover stranded costs caused by the retail wheeling.

Other

In this section we resolve questions concerning our information reporting requirements, regional transmission groups, and the special situations posed by utilities in the Pacific Northwest and by the federal power marketing and similar agencies. Here we make some minor clarifications but make no significant changes to Order No. 888.

We are not persuaded that the information reporting requirements need to be changed at this time. Finally, we reject arguments that would have us fix generically any particular rate methodology for providing open-access transmission service under the *pro forma* tariff.

II. Public Reporting Burden

This order on rehearing issues a number of minor revisions to the Final Rule. We find, after reviewing these revisions, that they do not, on balance, increase the public reporting burden.

The Final Rule contained an estimated annual public reporting burden based on the requirements of the Open Access Final Rule and the Stranded Cost Final had the opportunity to protest the compliance filings when they were tendered,[447] but these customers also have the right to file section 206 requests to change these tariffs at any time. In addition, Blue Ridge's request that customers be given 45 days to respond to compliance filings instead of 15 days is moot. In an order issued July 2, 1996,[448] we took three actions to address this concern: (1) we gave entities 30 days, instead of 15 days, to respond to Order No. 888 compliance filings; (2) we agreed to post an electronic version of all Order No. 888 compliance filings on the Commission's Electronic Bulletin Board; and (3) we required all public utilities making a compliance filing to also serve a copy of their filing on electronic diskette to any eligible customer or state regulatory agency requesting a copy. We believe that these actions not only provided all interested parties with access to the compliance filings more quickly, but also provided these parties sufficient time to analyze the information once they received it.[449] Moreover, the time periods provided for making and responding to Order No. 888 compliance filings have expired.

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[447] We do note that most of these concerns have been addressed in our orders dealing with the compliance filings on non-rate terms and conditions. *See, e.g., Atlantic City Electric Company, et al.*, 77 FERC ¶61,144 (1996); *Allegheny Power System, Inc., et al.*, 77 FERC ¶61,266 (1996).

[448] 76 FERC ¶61,009, at pp. 61,026-27 (1996) (July 2 Order).

With regard to Blue Ridge's first clarification request, we provide the following guidance. Utilities that had pending open-access filings at the time that the Final Rule was implemented had the non-price terms and conditions of those pending tariffs superseded by their Order No. 888 compliance filings. Any customer concerns about the non-rate tariff terms and conditions in the compliance filing should be raised in the compliance docket, and any future customer concerns should be raised in a separate, future section 206 complaint filed by the customer.

Furthermore, we reject Indianapolis P&L's rate issue because, if this utility believes that it operates under special circumstances that requires it to use "non-conforming" pricing methods, it is free to file such a proposal under section 205. The merits of Indianapolis P&L's arguments are more appropriately addressed in such a section 205 proceeding. The Commission will not alter its generic policy (which is the subject of this rulemaking) merely to address the particular needs of one party.

In addition, with regard to both of Indianapolis P&L's concerns, we note that pursuant to the Commission's July 2 Order, the Commission indicated that it would not address waiver requests in a generic proceeding and that parties would have to file such requests separately for separate docketing. We further note that Indianapolis P&L filed a separate waiver request on July 9, 1996, which was docketed as OA96-81.[450]

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[449] We also note that utilities were required in Order No. 888 to explicitly identify any regional practices in their compliance filings.

We also reject Union Electric's argument that the final rules violate procedural due process. Union Electric has had every opportunity to raise arguments with regard to every step in the Commission's derivation and implementation of the final rules. Moreover, with regard to Union Electric's claim that it was given an adequate amount of time to comprehend and implement the final rules, we note that virtually every public utility, including Union Electric, complied with the Open Access Rule on a timely basis, and there have been very few complaints that the rules are hard to comprehend.

I. *Federal and State Jurisdiction: Transmission/Local Distribution*

In the Final Rule, the Commission explained that after reviewing the extensive analysis of the FPA, legislative history, and case law contained in both the initial Stranded Cost NOPR and in the Open Access NOPR, and the comments received on that analysis, it reaffirmed its assertion of jurisdiction over the transmission component of an unbundled interstate retail wheeling transaction.[451] The Commission also reaffirmed and clarified its determinations regarding the tests to be used to determine what constitute Commission-jurisdictional transmission facilities and what constitute state-jurisdictional local distribution facilities in situations involving unbundled wholesale wheeling and unbundled retail wheeling.

The Commission also explained that where states unbundle retail sales, it will give deference to their determinations as to which facilities are transmission and which are local distribution, provided that the states, in making such determinations, apply the seven criteria discussed in the NOPR and reaffirmed by the Commission. In addition, the Commission clarified that there is an element of local distribution service in any unbundled retail transaction, and further clarified other aspects of its jurisdictional ruling to preserve state jurisdiction over matters that are of local concern and will remain subject to state jurisdiction if retail unbundling occurs.

The Commission reaffirmed its legal determination that if unbundled retail transmission in interstate commerce occurs voluntarily by a public utility or as a result of a state retail access program, this Commission has exclusive jurisdiction over the rates, terms, and conditions of such transmission. The Commission found compelling the fact that section 201 of the FPA, on its face, gives the Commission jurisdiction over transmission in interstate commerce (by public utilities) without qualification.

The Commission further explained that when a retail transaction is broken into two or more products that are sold separately, the jurisdictional lines change. In this situation, the Commission emphasized that the state clearly retains jurisdiction over the sale of the power, but the unbundled transmission service involves only the provision of "transmission in the interstate commerce" which, under the FPA, is exclusively within the jurisdiction of the Commission.

The Commission recognized that in asserting jurisdiction over unbundled retail transmission in interstate commerce by public utilities, it was in no way asserting jurisdiction to order retail transmission directly to an ultimate consumer. It explained that its assertion of jurisdiction is that if unbundled retail transmission in interstate commerce by a public utility occurs voluntarily or as a result of a state retail wheeling program, the Commission has exclusive jurisdiction over the rates, terms, and conditions of such transmission and public utilities offer such transmission must comply with the FPA by filing proposed rate schedules under section 205.

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[450] By order issued September 1, 1996, the Commission denied Indianapolis P&L's requested waiver of all the requirements of Order No. 888. On October 8, 1996, Indianapolis P&L sought rehearing of that order and a stay of the requirements of Order No. 888. These pleadings are now pending before the Commission.

[451] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at pp. 31,780-85; mimeo at pp. 427-42.

The Commission further clarified that nothing in its jurisdictional determination changes historical state franchise areas or interferes with state laws governing retail marketing areas of electric utilities. It explained that while its jurisdiction cannot affect whether and to whom a retail electric service territory (marketing area) is to be granted by the state, and whether such grant is exclusive or non-exclusive, neither can state jurisdiction affect this Commission's exclusive jurisdiction over transmission in interstate commerce by public utilities.

The Commission also adopted a new section 35.27(b) as follows:

> Nothing in this part (i) shall be construed as preempting or affecting any jurisdiction a state commission or other state authority may have under applicable state and federal law, or (ii) limits the authority of a state commission in accordance with state and federal law to establish (a) competitive procedures for the acquisition of electric energy, including demand-side management, purchased as wholesale, or (b) non-discriminatory fees for the distribution of such electric energy to retail consumers for purposes established in accordance with state law.

With respect to the Commission's adoption of the Open Access NOPR's function/technical tests for determining what facilities are Commission-jurisdictional facilities used for transmission in interstate commerce and what facilities are state-jurisdictional local distribution facilities, the Commission concluded that it could not divine a bright line for unbundled retail transmission by the public utility that previously provided bundled retail service to the end user. The Commission added that the limited case law, including *Connecticut Light & Power Company v. FPC (CL&P) and Federal Power Commission v. Southern California Edison Company (the Colton case)*,[452] supports a case-by-case determination.[453] Accordingly, the Commission stated that its technical test, with its seven indicators, will permit reasoned factual determinations in individual cases.

The Commission made two clarifications regarding local distribution in the ontext of retail wheeling. First, it explained that even if its technical test for local distribution facilities were to identify no local distribution facilities for a specific transaction, states have authority over the service of delivering electric energy to end users. Second, the Commission explained that through their jurisdiction over retail delivery services, states have authority not only to assess retail stranded costs but also to assess charges for so-called stranded benefits, such as low-income assistance and demand-side management.

Thus, under this interpretation of state/federal jurisdiction, the Commission explained, customers have no incentive to structure a purchase so as to avoid using identifiable local distribution facilities in order to bypass state jurisdiction and thus avoid being assessed charges for stranded costs and benefits.

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[452] 324 U.S. 515 (1945) (CL&P); 376 U.S. 205 (1964) (Colton).

[453] The Commission included a detailed legal analysis in appendix G to Order No. 888. The Commission explained that it was particularly persuaded by the Supreme Court's Statement that whether facilities are used in local distribution is a question of fact to be decided by the Commission as an original matter. See CL&P, 324 U.S. at 534-35).

The Commission further determined that it is appropriate to provide deference to state commission recommendations regarding certain transmission/local distribution matters that arise when retail wheeling occurs.

In instances of unbundled retail wheeling that occurs as a result of a state retail access program, the Commission indicated that it will defer to recommendations by state regulatory authorities concerning where to draw the jurisdictional line under the Commission's technical test for local distribution facilities, and how to allocate costs for such facilities to be included in rates, provided that such recommendations are consistent with the essential elements of the Final Rule.[454] Moreover, the Commission indicated that it will consider jurisdictional recommendations by states that take into account other technical factors that the state believes are appropriate in light of historical uses of particular facilities.

As a means of facilitating jurisdictional line-drawing, the Commission stated that it will entertain proposals by public utilities, filed under section 205 of the FPA, containing classifications and/or cost allocations for transmission and local distribution facilities. However, the Commission explained that, as a prerequisite to filing transmission/local distribution facility classifications and/or cost allocations with the Commission, utilities must consult with their state regulatory authorities. If the utility's classifications and/or cost allocations are supported by the state regulatory authorities and are consistent with the

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[454] In order to give such deference, the Commission noted its expectation that state regulators will specifically evaluate the seven indicators and any other relevant facts and make recommendations consistent with the essential elements of the Rule.

principles established in the Final Rule, the Commission indicated that it will defer to such classifications and/or cost allocations.

Furthermore, the Commission stated that deference to state commissions with regard to rates, terms, and conditions may be appropriate in some circumstances. The Commission explained that when unbundled retail wheeling in interstate commerce occurs, the transaction has two components for jurisdictional purposes—a transmission component and a local distribution component. It again emphasized that the Commission has jurisdiction over facilities used for the transmission component of the transaction, and the state has jurisdiction over facilities used for the local distribution component. Thus, the Commission stated, the rates, terms and conditions of unbundled retail transmission by a public utility must be filed at the Commission. However, the Commission added, if the unbundled retail wheeling occurs as part of a state retail access program, it may be appropriate to have a separate retail transmission tariff[455] to accommodate the design and special needs of such programs. In such situations, the Commission indicated that it will defer to state requests for variations from the FERC wholesale tariff to meet these local concerns, so long as the separate retail tariff is consistent with the Commission's open-access policies and comparability principles reflected in the tariff prescribed by the Final Rule. In addition, the Commission indicated that the rates must be consistent with its Transmission Pricing Policy Statement, and the guidance set forth in Order No. 888 concerning ancillary services.[456]

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[455] The Commission noted that such a tariff could be different from the tariff that applies to wholesale customers, but that such tariff would still be filed with the Commission under FPA section 205.

[456] In applying the principles of the Final Rule to retail transmission tariffs, the Commission emphasized that it clearly cannot order retail wheeling directly to an ultimate consumer. (citing FPA section 212(h)).

The Commission also expressed concern, just as it did with buy-sell arrangements in the gas industry, that buy-sell arrangements can be used by parties to obfuscate the true transactions taking place and thereby allow parties to circumvent Commission regulation of transmission in interstate commerce. Thus, the Commission reaffirmed its conclusion that it has jurisdiction over the interstate transmission component of transactions in which an end user arranges for the purchase of generation from a third-party. Moreover, the Commission indicated that it will address these transactions on a case-by-case basis.

Rehearing Requests

Oppose Commission Assertion of Jurisdiction Over Unbundled Retail Transmission

Several state commissions indicate that, recognizing that the case law is not dispositive concerning the question of unbundled retail transmission services (either because the cases do not involve the transmission of power to retail customers or "fence off" local distribution from federal regulation); at least one court (*Wisconsin-Michigan Power Company v. FPC*, 197 F.2d 472 (7th Cir. 1952), *cert. denied*, 345 U.S. 934 (1953)) explicitly applied the wholesale/retail distinction to distinguish transmission and local distribution services.[457] Thus, they argue, the Commission should apply the wholesale versus retail analysis to the question of unbundled retail transmission.

IL Com asserts that retail transmission by a public utility directly to an end user has always (even before the FPA was enacted) been subject to regulation by the states. It contends that no change in law has occurred which justifies the Commission's claim of expanded jurisdiction. Moreover, it disagrees with the Commission's conclusion that the unbundled delivery by the previous public utility generation supplier directly to an end user is in interstate commerce. It argues that the FPA was never intended to disturb the jurisdiction of state regulators that existed prior to its passage and that retail transmission of electric energy by a public utility to an end user was under state jurisdiction before the *Attleboro* decision and has remained under state jurisdiction in the over sixty years following *Attleboro*. Even after unbundling, according to IL Com, transmission to a retail customer still involves a retail sale of transmission.

NARUC and VA Com assert that the legislative history provides little support for the Commission's conclusion that the act of unbundling generation from delivery serves to shift jurisdiction from a state commission to the Commission. If anything, they contend, the jurisdictional structure of the FPA is predicated on the distinction between retail and wholesale transactions, not bundled and unbundled services. They assert that the Commission should conclude that the rates, terms and conditions of service for delivery of power by a utility to an end-use customer are subject to the jurisdiction of the state commission regulating the utility, regardless of the identity of the party generating or reselling the power or the facilities used to transport the power.

NARUC asserts that the Commission did not address a point raised in NARUC's reply comments as to how the removal of generation serves to unbundle the retail delivery function into separate transmission and distribution services. It maintains that the Commission simply assumes that a resulting transmission

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[457] *E.g.*, NARUC, WI Com, WY Com.

transaction is created when power is sold to a retail consumer by someone other than the utility delivering the power.[458]

MI & NH Coms ask the Commission to vacate those portions of the Rule that find that the Commission has jurisdiction over the transmission component of an unbundled retail sale in a local retail wheeling transaction. They assert that the Commission should confine its activity to wholesale transactions or those interstate transactions that do not implicate matters to local concern. They argue that the dual federal/state regulatory scheme establishes that Congress' intent is that state regulation of retail wheeling is *not* preempted by federal law as established in FPA section 201. They oppose unnecessary federal intrusion into local matters under a one-size-fits-all approach and assert that the retail wheeling initiatives in New Hampshire and Michigan are tailored to the unique utility environment in each state.

Central Illinois Light argues that unbundling of retail electric service does not change the states' longstanding jurisdiction over retail electric service and local distribution, even when that service involves the use of transmission in interstate commerce. It asserts that 201(b)(1) ("transmission of electric energy in interstate commerce") cannot be read in a vacuum.

MN DPS & MN Com and OH Com assert that the Commission should have no role in the regulation of retail services, be they bundled or unbundled. They argue that, in refusing to grant the Commission authority over retail wheeling, Congress left jurisdiction over retail electric service to the states.

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[458] *See also* IA Com (use of a utility's transmission system to serve its own retail customers is a bundled part of the retail sale transaction, which supports a simpler jurisdictional test holding that a movement of power by the last utility in any chain of delivery to a retail customer is a distribution transaction).

They conclude that the Final Rule contains insufficient legal and/or policy justification for the Commission's assertion of jurisdiction over unbundled retail transmission services.

MN DPS & MN Com assert: "FERC bases its usurpation of state authority over retail transmission rates on its claim that balkanization would occur without the assertion of FERC authority. Therefore, the parties are entitled to rehearing so that this essential issue can be further analyzed." (MN DPS & MN Com at pp. 1-3).

FL Com argues that the Commission has not justified why the act of unbundling prices expands the Commission's jurisdiction into retail marketing areas. It argues that Section 212(g) of the FPA has the effect of prohibiting the Commission from usurping existing state jurisdiction over retail transmission service, whether bundled or unbundled. According to FL Com. FERC's jurisdiction over transmission terminates at the territorial boundary of each electric utility in Florida. It supports wheeling in jurisdiction for state commissions and wheeling out and wheeling through jurisdiction for the Commission.

IN Com opposes federalization of retail wheeling transactions within a state's boundaries as contrary to the FPA's legislative history and case law.

NJ BPU asserts that by claiming jurisdiction over unbundled retail transmission, the Commission is creating a disincentive for states to implement retail access because, by ordering retail access, the states may be relinquishing their jurisdiction over unbundled retail transmission terms and conditions—jurisdiction that they would maintain under a bundled scenario.[459] PA Com argues that the Commission does not have the authority to order retail wheeling and that the jurisdictional formula is challengeable on engineering and legal grounds. It concludes that the Commission does not have jurisdiction over unbundled interstate retail transmission service, PA Com notes that the 1996 House and Senate hearings have raised the question whether the Commission has the statutory authority to restructure the electric industry. PA Com questions the Commission's definition of the "traditional tasks of state and federal regulators" on the basis of section 201(b) of the FPA, the Supremacy Clause, and the Tenth Amendment of the U.S. Constitution.

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[459] *See also* PA Com.

Support Broader Assertion of Jurisdiction by the Commission Over Retail Wheeling

NY Utilities declare that the Commission has jurisdiction over retail wheeling from the source to the load, but does not have jurisdiction over transmission in bundled retail service. They assert that the Commission's reliance on state jurisdictional local distribution as a predicate to abstain from allowing retail wheeling stranded cost recovery is without foundation. They further assert that a unique element that sets local distribution apart from transmission is not the size of the facility or the length of travel, but that transportation is bundled with a retail sale. According to NY Utilities, the plain meaning of the FPA shows that local distribution is bundled retail service. They claim that the legislative history, to the extent necessary, and court cases support FERC jurisdiction over all aspects of retail wheeling, but makes clear that the Commission cannot regulate bundled retail service. They add that the NGA also demonstrates that local distribution means bundled retail service.

Commission Conclusion

In concluding that this Commission has exclusive jurisdiction over the rates, terms and conditions of unbundled retail transmission by public utilities in interstate commerce, the

Commission in Order No. 888 thoroughly examined the statutory language of the FPA and its legislative history, and relevant FPA and NGA case law. While the state commissions on rehearing would like us to draw a bright line that gives them, to varying degrees, jurisdiction over retail interstate transmission by public utilities, no party on rehearing has raised any legislative history or case law that was not previously considered and that would support the proposition that states have jurisdiction over any unbundled transmission in interstate commerce. As explained below, we reaffirm our jurisdictional interpretation on rehearing and believe that it is supported by the recent decision in *United Distribution Companies v. FERC.*[460]

Many of the rehearing arguments focus on the fact that states historically (even prior to the FPA) regulated retail transmission insofar as it was a component of bundled electric service to an end user, and they argue that by asserting jurisdiction over unbundled retail transmission, the Commission is somehow "taking away" jurisdiction the states previously had. The flaw in these arguments is their inherent assumption that jurisdiction over transmission service turns upon the question of whether the transmission service is being provided for "wholesale" or "retail" power sales. That is not the case. The question of jurisdiction rather turns upon the extent of the Commission's exclusive jurisdiction over transmission in interstate commerce under the FPA. The fact that states historically regulated most retail transmission service as a part of a bundled retail power sale is not the result of a legal requirement; it is the practical result of the way electricity has historically been bought and sold. However, the shape of power sales transactions is rapidly changing. Rather than claiming "new" jurisdiction; the Commission is applying the same statutory framework to a business environment in which, as discussed below, retail sales and transmission service are provided in separate transactions.

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[460] 88 F.3d 1105, 1152-53 (1996) (United Distribution Companies).

In the past, retail sales occurred almost exclusively on a bundled basis (i.e., the same entity provided a delivered product called electric energy and transmission was part and parcel of that product). The FPA clearly reserves the right to regulate retail sales of electric energy to the states. As we explained in the Final Rule, however, in today's markets, and increasingly in the future as more states adopt retail wheeling program, retail transactions are being broken into products that are being sold separately; transmission and generation. Moreover, these products are being sold increasingly by two or more different entities. For example, a transaction may involve transmission service from one or more transmission providers who move power from a distant generation supplier, over the interstate transmission grid, to an end user. Because these types of products and transactions were not prevalent in the past, the jurisdictional issue before us did not arise and, contrary to IL Com's argument, the Commission cannot be viewed as "disturbing" the jurisdiction of state regulators prior to and after the *Attleboro* case.[461]

As we also explained in the Final Rule, the legislative history of the FPA and the relevant case law similarly reflect the historical market structure in which electricity and transmission generally were bought on a bundled basis.[462] Today's unbundled world simply was not contemplated and the cases do not resolve dispositively this jurisdictional issue. The case law focuses primarily on the bright line between wholesale sales and retail

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[461] *Public Utilities Commission v. Attleboro Steam & Electric Co.*, 273 U.S. 83 (1927).

[462] The case law is addressed extensively in appendix G to the Final Rule and will not be repeated here.

sales of energy, and transmission in interstate as opposed to intrastate commerce. It does not address unbundled retail interstate transmission.[463] We therefore have interpreted the case law in light of changed circumstances and have relied in the first instance on the plain wording of the statute. We find compelling that section 201 of the FPA, on its face, gives the Commission jurisdiction over transmission in interstate commerce without qualification; unlike our jurisdiction over sales of electric energy, which section 201 specifically limits to sales at wholesale, the statute does not limit our transmission jurisdiction over public utilities to wholesale transmission.

Since the time Order No. 888 issued, the D.C. Circuit has addressed a similar issue in interpreting section 1(b) of the NGA, the provision that parallels section 201(b) of the FPA. Under section 1(b), the Commission's jurisdiction does not apply "to the local distribution of natural gas or to the facilities used for such distribution." Similarly, under section 201(b) of the FPA, the Commission shall not have jurisdiction, except as specifically provided, "over facilities used for the generation of electric energy or over facilities used in local distribution ..." In responding to arguments regarding the scope of state authority over "local distribution" of natural gas, the court distinguished between bundled and unbundled sales:

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[463] On rehearing, several parties argue that at least one court case, *Wisconsin-Michigan Power Co. v. FPC*, 197 F.2d 472 (7th Cir. 1952), *cert denied*, 345 U.S. 934 (1953) explicitly applied the wholesale/retail distinction to distinguish transmission and local distribution services. The Commission discussed this case in detail in appendix G to the Final Rule. *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at pp. 31,974-75; *mimeo* at pp. 22-25. As we stated there, the court's interpretation of the legislative history of the FPA was at odds with both the plain words of the statute as well as the language of the House Report on the FPA (H.R. Rep. No. 1318 at p. 27). It also did not mention the Senate Report on the FPA, which clearly recognized jurisdiction over all interstate transmission lines, whether or not a sale of energy is carried by those lines (S. Rep. No. 621 at p. 48). We therefore reject arguments that this single case is in any way dispositive of the issue before us.

> States have been—and are still—permitted to regulate LDC's bundled sales of natural gas to end-users because those transactions include transportation over local mains and the retail sales of gas. In contrast, states have *never* regulated the terms and conditions of interstate pipeline transportation. When the gas sales element is severed—i.e., unbundled—from the transactions, FERC retains jurisdiction over the *interstate transportation* component." *(United Distribution Companies*, 88 F.3d at 1153 (footnote omitted) (emphasis in original).)

The court's reasoning is also applicable to and supports our jurisdictional determination in Order No. 888.

Several state commissions point to section 212(h) of the FPA and argue that Congress in refusing to grant the Commission authority over retail wheeling, left all jurisdiction over retail transmission to the states. We disagree. What Congress did in section 212(h) was to prohibit us from *ordering* transmission directly to an ultimate consumer. We readily recognize and respect this prohibitation. However, the ability to order retail wheeling is a separate issue from whether we have jurisdiction over the rates, terms and conditions of retail wheeling in interstate commerce that is ordered by a state or that is provided voluntarily. Congress, in enacting section 212(h), did nothing to modify our jurisdiction under sections 201, 205 and 206 over the rates, terms and conditions of interstate transmission by public utilities.

Similarly, we reject FL Com's arguments that section 212(g) of the FPA prohibits the Commission from asserting any jurisdiction over unbundled retail transmission. Section 212(g) prohibits the Commission from issuing an order that is

inconsistent with any state law that governs retail marketing areas of electric utilities. As we stated in the Final Rule, while our jurisdiction cannot affect whether and to whom a retail electric service territory (marketing area) is to be granted by the state, and whether such grant is exclusive or non-exclusive, neither can state jurisdiction affect this Commission's exclusive jurisdiction over the rates, terms and conditions of transmission in interstate commerce by public utilities. We also reject arguments by the FL Com that this Commission's jurisdiction over transmission terminates at the territorial boundary of each electric utility in Florida. This argument is flatly contrary to the longstanding interpretation of the FPA by the United States Supreme Court.[464]

Commission's Seven Factor Test

IL Com argues that the Commission should withdraw its technical test. It contends that retail wheeling jurisdiction should follow function and that the function served by public utility facilities in providing retail service does not change upon the unbundling of service to retail customers. According to IL Com, Commission jurisdiction would extend to the service of delivering electric energy by a public utility to wholesale customers, regardless of the nature and extent of the public utility's facilities used to make that delivery. Similarly, it asserts state jurisdiction would extend to the service of delivering electric energy by a public utility directly to retail customers, regardless of the nature and extent of the public utility's facilities used to make that delivery.

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[464] *See FPC v. Southern California Edison Co.*, 376 U.S. 205 (1964) (Colton case). IN Com makes a similar argument and opposes "federalization" of retail wheeling within a state's boundaries. We reject this argument on the same basis.

NARUC argues that the seven-factor test does not result in the bright line discussed in *FPC v. Southern California Edison Company*, 376 U.S. 205 (1964). The facility-by-facility categorization of utility systems on a company-specific basis, it asserts, is hardly consistent with the Court's decision to make case-by-case analysis unnecessary.

OH Com asserts that the seven factors provide no useful insight into the nature of local distribution service. It adds that reliance upon technical tests to determine local distribution lacks legal foundation. It further contends that the jurisdictional bright line established by Congress focuses upon the nature of the transaction, not the functional or technical characteristics of a particular wire, in determining whose jurisdictional authority attaches to a particular transaction and facilities. It concludes that the Commission should adopt the Ohio-proposed retail marketing area, "wheeling in" jurisdictional approach.

PA Com contends that the Commission's seven indicia are not acceptable measures of local distribution and challenges each factor.

NH & MI Coms declare that the criteria for distinguishing transmission facilities from local distribution facilities should not be limited to the seven given in the Rule, but should allow consideration of any other relevant criteria for separating local concerns from matters legitimately federal in nature.

NJ BPU argues that the engineering-driven definition does not resolve many of the hazy areas. To the extent that the seven factors do not reflect or cannot be reconciled with the particular circumstances, it contends that the states may be hamstrung in

their ability to make reasoned decisions that comport with Order No. 888.[465]

Similarly, NY Com argues that five of the seven factors (1, 2, 4, 6, and 7) are not accurate when applied to large metropolitan areas and remote rural areas. It asserts that local distribution facilities are not necessarily close to retail customers and the assumption that local distribution facilities are primarily radial in character fails to account for network systems. It adds that reconsignment or transportation of power to different markets can and does occur at the local distribution level. It further adds that the presence of meters is not a discerning characteristic of where interstate transmission ends and local distribution begins; meters are frequently not part of the transmission/local distribution interface. Nor, according to NY Com, are local distribution systems necessarily of reduced voltage. Instead of the 7 criteria, NY Com argues that the Commission should adopt a functional measure of local distribution based on factors 3 and 5 (interstate transmission ends and local distribution begins where electricity flows into a comparatively restricted geographic area and does not flow back out of that area and the power is consumed in that area) and on the traditional classification of the facilities by the state regulatory body (or what the utility has traditionally classified as local distribution).

Commission Conclusion

Several parties on rehearing do not like the seven-factor technical test for local distribution facilities that was set forth in Order No. 888. That test takes into account both technical and functional characteristics of the transaction involved. The parties on rehearing propose instead a variety of bright line tests. For example, IL Com wants state jurisdiction to extend to the "service" of delivering electric energy to retail customers, which it would define to give it jurisdiction regardless of the nature and extent of the facilities used to make the delivery. OH Com proposes that the Commission adopt a retail marketing area "wheeling in" jurisdictional approach which would give it jurisdiction over facilities within territorial boundaries.

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[465] *See also* WI Com (criteria do not appropriately reflect the mixed nature of many facilities in systems that are closely integrated and the application of the criteria to the electric system in Wisconsin would supplant state jurisdiction over a large number of facilities whose primary functions are local reliability and retail service).

In response, we do not interpret the FPA to permit us in effect to rewrite the statute to give states jurisdiction over interstate transmission services. Moreover, we reject arguments of OH Com that our seven-factor test lacks legal foundation, and arguments of NARUC that we are somehow bound to develop a bright line test. While Congress established a jurisdictional bright line between wholesale and retail sales of energy, there is no such bright line that we can divine with regard to transmission and local distribution facilities. The Supreme Court, in both *Colton* and *CL&P*,[466] has instructed us that whether facilities are used in local distribution is a question of fact to be decided by the Commission as an original matter. The seven factors will permit us to undertake this fact-specific determination.

We acknowledge the concerns raised by several state commissions that the seven-factor test does not, as NJ BPU puts it, resolve many of the hazy areas, and that there may be other factors that should be taken into account in particular situations. The seven-factor test is intended to provide sufficient flexibility to take into account unique local characteristics and historical usage of facilities used to serve retail customers. We specifically stated in the Final Rule that we will consider jurisdictional recommendations by states that take into account other technical

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[466] *See Colton*, 376 U.S. at 210 n.6: CL&P, 324 U.S. at 531-36.

factors that states believe are appropriate in light of historical uses of particular facilities. Moreover, we will defer to facility classifications and/or cost allocations that are supported by state regulatory authorities. For example, in the ongoing California electric utility restructuring proceeding, the Commission deferred to the State PUC's recommendations regarding the split between state jurisdictional local distribution facilities and Commission-jurisdictional transmission facilities.[467]

Oppose transmission of public utility purchases for sale at retail

IL Com objects to the transmission unbundling requirement if it is intended to require public utilities to take transmission services under their own FERC tariffs for purchases of power intended for distribution by the public utility to retail customers. According to IL Com, a distinction must be made between the public utility's use of its transmission system in cases in which the public utility purchases wholesale power for sale for resale, and cases in which the public utility purchases wholesale power to serve native load retail customers. It argues that the Commission cannot legally regulate, or place conditions on, the manner in which a utility uses its transmission system to make sales of electric energy at retail. It contends that the Commission must exempt public utility power purchases for sale at retail from the unbundling requirement. It recommends that the Commission insert the words "for sale for resale" after the word "purchases" in section 35.28(c)(2) and after the word "purchase" in section 35.28(c)(2)(i).

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[467] *Pacific Gas and Electric Company, et al.*, 77 FERC ¶61,325, at p. 61,325 (1996).

Commission Conclusion

The Commission rejects arguments of IL Com that if unbundled retail wheeling occurs either voluntarily or as a result of a state retail program, we cannot require the utility to take service under its own transmission tariff for sales to retail customers. This requirement is a term and condition of unbundled retail interstate transmission service and, as explained above, therefore is within our exclusive jurisdiction. Additionally, this should not in any way infringe on state retail programs or service to retail customers. Rather, it ensures that non-discriminatory transmission services are provided to all potential retail power competitors.

Further, as stated previously in section IV.C.1.b (Transmission Providers Taking Service Under Their Tariff), we clarify that a transmission provider does not have to "take service" under its own tariff for the transmission of power that is purchased on behalf of bundled retail customers.

Oppose buy-sell transaction analysis

PA Com asserts that there is a potential for jurisdictional conflict with respect to buy-sell transactions that is a direct consequence of the technical-functional test (which PA Com challenges).

IL Com argues that states have exclusive authority to regulate buy-sell arrangements as bundled retail sales. It further argues that the Commission cannot make a bundled retail sale into an unbundled retail sale simply by characterizing it as the functional equivalent of an unbundled retail sale; by re-characterizing them the Commission is effectively ordering the unbundling of buy-sell arrangements. It asserts that buy-sell arrangements on the electric side are not an end run around clear federal jurisdiction and that the Commission should withdraw its assertion of jurisdiction over the retail transmission component of unbundled retail sales.

VT DPS contends that the Commission's rationale is flawed. "FERC's analysis rests on the same very shaky ground as its similar claim of jurisdiction over buy-sell arrangements by local gas distribution companies."According to VT DPS, all retail transactions are subject to state jurisdiction and asks the Commission to clarify that the Commission defines buy-sell as it did in the NOPR, but also acknowledge that it has no jurisdiction over such arrangements.

IN Com asserts that in the absence of any record of abusive and undermining actions by states under the guise of buy-sell arrangements, there is not even a remedial justification to touch buy-sell transactions. It contends that a difference between the FPA and the NGA warrants different treatment—the FPA exempts from FERC jurisdiction local distribution and transmission of electric energy in intrastate commerce. By redefining interstate transmission, INC Com claims that the Commission proposes to do away with the meaning history has accorded to a variety of transactions previously considered wholly intrastate in nature. According to IN Com, states should be allowed to experiment with and allow different forms of buy-sell transactions as part of the evolving marketplace.

Commission Conclusion

Four parties (PA Com, IL Com, VT DPS and IN Com) have raised concerns regarding the Commission's determination that it has jurisdiction over the interstate transmission component of transactions in which an end user arranges for the purchase of generation from a third party. The Commission reiterates that we will have to address these situations on a case-by-case basis. We disagree with IL Com that States have exclusive authority to regulate the interstate transmission component of buy-sell transactions. Similarly, we deny the VT DPS request that we acknowledge no jurisdiction over such arrangements. The fact remains that these arrangements could be used by parties to obfuscate the true transactions taking place and thereby allow parties to circumvent Commission regulation of transmission in interstate commerce. We reserve our authorities to ensure that public utilities and their customers are not able to circumvent non-discriminatory transmission in interstate commerce. In response to VT DPS' contention that the Commission's analysis here rests on the same shaky ground as its similar claim of jurisdiction over buy-sell arrangements by local gas distribution companies, we note that the D.C. Circuit recently affirmed the Commission's assertion of jurisdiction over buy/sell arrangements under the Natural Gas Act.[468]

State jurisdiction over the service of delivering electric energy to end users

Rehearing Requests

IL Com states that it is far from clear what FERC contemplates by the "service" of delivery of electric energy by a delivering utility in the retail wheeling transaction. It is equally unclear to IL Com whether the "service" to which Order No. 888 refers is a public utility activity over which state regulators would have jurisdiction. IL Com argues that it is the Illinois legislature, not FERC, that determines whether IL Com can regulate something called "delivery service."[469]

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[468] *United Distribution Companies*, 88 F.3d at 1154-57.

[469] *See also* AK Com (should not create a fictional concept of delivery service—the legal reality is that, under retail competition, state law will establish a customer's right to be served and a generation owner's right to produce power. AK Com asserts that the state can then attach conditions to those rights).

MO/KS Coms ask the Commission to clarify the meaning of the statement that even when the test for local distribution facilities identifies no local distribution facilities, the Commission believes that states have authority over the service of delivering electric energy to end users. According to MO/KS Coms:

> "The authority to shop at retail and to sell at retail do not exist in the FPA. If the Commission's goal is to recognize the States' authority to establish conditions on retail competition, it need only acknowledge the State jurisdiction to establish the opportunity to shop and sell at retail. If this is what the Commission is seeking to accomplish by its discussion of 'delivery service' then we support the Commission."[470]

Coalition for Economic Competition asserts that the Commission failed to consider that the sale of electric energy may take place outside of the state into which the energy is transmitted, and that the local regulatory commission may have no jurisdiction over either the sale or the transmission of the energy.

Commission Conclusion

Several parties ask us to clarify our conclusion that even when the seven-factor test for local distribution facilities does not identify local distribution facilities, we believe states have authority over the "service" of delivering electric energy to end users. We clarify that states have the authority to determine the retail marketing areas of electric utilities within their jurisdictions, and the end user services that those utilities must provide, but we did not in Order No. 888 intend to opine on the extent of authority given by state legislatures to their state commissions. Rather, our statement regarding state authority over the "service" of delivering electric energy is intended to recognize the historical and local nature of delivering power to end users and the states' legitimate concerns and responsibilities in regulating local matters.

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[470] MO/KS Coms at pp. 1-13.

Deference to states

Rehearing Requests

Support broader deference

NARUC and IL Com argue that the Commission should not simply defer to state recommendations concerning the application of the seven-factor test or the recovery of stranded costs, but should conclusively rely on the findings by state commissions.

NY Com argues that the Commission should not limit deference to instances in which states order retail wheeling, but should defer to all state commission recommendations regarding the definition of local distribution facilities.

FL Com asserts that the Rule fails to [illegible] where deference will be given. It argues that the Rule shou[illegible] state that when a state commission has held a proceeding on matters related to the requirements of the Rule, the Commission shall give deference to the state commission decisions. Moreover, it asserts that the Commission should codify the deference stranded: "When a state commission has held a proceeding on matters related to the requirements of this rule, the Commission shall give deference to the state commission decisions." (FL Com at pp. 7-9).

The commitment to defer to a state regulatory commission or agency, argues NE Public Power District, should be clarified with respect to utilities located in Nebraska, which has no such commission or agency. NE Public Power District assumes that

deference will be accorded to decisions of NE Public Power District's Board of Directors; if not, it asks the Commission to clarify.

PA Com asks the Commission to clarify what a state regulatory agency must demonstrate to secure deference and to define the term "consult." PA Com states that, in discussing the seven indicia, the Commission states that it will "consider" jurisdictional recommendations by states, which PA Com asserts is much different from deference. It also asserts that the Commission must clarify what it will do if a utility's classifications and/or cost allocations are not supported by state regulatory authorities.

Oppose deference to state authorities

TANC argues that the Commission erred in deferring to state regulatory authorities in drawing jurisdictional lines for local distribution facility classifications and/or cost allocations. According to TANC, the Commission unlawfully and unnecessarily abdicated its jurisdiction under the FPA (citing *New England Power Co. v. New Hampshire,* 455 U.S. 331, and *Nantahala Power and Light Co. v. Thornburg*, 476 U.S. 953). With respect to ISOs, it asserts that the Commission should not defer to state authority in making determinations with respect to classifications of facilities.

Commission Conclusion

In response to NARUC an IL Com's arguments that this Commission should not simply defer to state commissions regarding application of the seven-factor test but instead should conclusively rely on the findings of state commissions, we believe this is inconsistent with the case law which states that local distribution is a matter of fact for the Commission to determine as an original matter.[471] Additionally, we have an independent obligation to ensure that we are fulfilling our responsibilities under the FPA to regulate facilities that are used in interstate commerce. We cannot delegate our jurisdiction. However, we intend to provide broad deference to states in determining what facilities are Commission-jurisdictional transmission facilities and what facilities are state-jurisdictional local distribution facilities, so long as our comparability principles are not compromised and we are able to fulfill our responsibilities under the statute.

We reject FL Com's suggestion that we codify the deference standard. This is neither necessary nor appropriate. In response to NE Public Power District's request that we clarify to whom we would give deference in Nebraska, we clarify that because Nebraska does not have an electric regulatory commission or agency, there is no appropriate regulatory entity to whom our deference standard would apply; accordingly, we will address the transmission/local distribution issue for Nebraska without giving deference to any particular entity. In response to PA Com's request that we clarify what we will do if a utility's classifications and/or cost allocation proposals are not supported by state regulatory authorities, we will make a determination based on the factual record before us in a particular case, taking into account the views of the state regulatory authority.

TANC has argued that we have unlawfully abdicated our jurisdiction by deferring to state recommendations. TANC confuses delegation of jurisdiction, which we cannot do with willingness to defer to states based on their application of criteria that we have provided. Even in the cases in which the Commission defers to states' views, we will still independently evaluate all material issues and proceed only where substantial

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[471] *See Colton* and *Connecticut Light and Power, supra.*

evidence supports the states' views. The Commission clearly can entertain requests for deference in these circumstances.

J. *Stranded Costs*

As indicated in our prior discussion in Section IV.A.5. there are two major overlapping transition issues that arise as a result of this rulemaking: stranded cost recovery and how to deal with contracts entered into under the prior regulatory regime. We here address stranded cost recovery and, as in the prior discussion, we believe it is important to explain the general context in which our stranded cost determinations have been made before addressing the various rehearing requests on this issue.

In Order No. 888, the Commission removed the single largest barrier to the development of competitive wholesale power markets by requiring non-discriminatory open-access transmission as a remedy for undue discrimination. This action carries with it the regulatory public interest responsibility to address the difficult transition issues that arise in moving from a monopoly, cost-based electric utility industry to an industry that is driven by competition among wholesale power suppliers and increasing reliance on market-based generation rates. The most critical transition issue that arises as a result of the Commission's actions in this rulemaking is how to deal with the uneconomic sunk costs that utilities prudently incurred under an industry regime that rested on a regulatory framework and a set of expectations that are being fundamentally altered.

The Commission determined in Order No. 888 that it must address stranded costs, and that it must do so at an early stage—particularly in light of the lessons learned from our experience with similar issues in the natural gas area. We noted that when we did a similar restructuring in the gas industry, the D.C. Circuit invalidated the Commission's efforts precisely because the Commission had failed to deal with the stranded cost problem in a satisfactory manner.[472] We explained that, based on the lesson of AGD, the Commission cannot change the rules of the game without providing a mechanism for recovery of the costs caused by such regulatory-mandated change.

Since the time Order No. 888 issued, we have been provided with additional guidance from the court in the natural gas area, which has further helped to inform our decisions here. In its decision on review of Order No. 636,[473] the D.C. Circuit upheld the Commission's decision to allow the recovery of gas supply realignment costs. In so doing, the court, while questioning a specific feature of the stranded cost recovery mechanism employed in Order No. 636, has nevertheless again reaffirmed the basic principle that stranded cost recovery is an appropriate component of a regulatory policy aimed at accomplishing a fair and reasonable transition to competitive markets. The question as to the Commission's ability to allow the recovery of stranded costs has been laid to rest.

The task before the Commission in this rulemaking is thus to determine how best to meet its responsibility to address the costs of the transition to a competitive industry, particularly insofar as those costs are stranded, or in effect rendered unrecoverable, as a result of the transmission access required by us under the FPA.[474] As the rehearing arguments demonstrate, there is no consensus on how the Commission should address the stranded cost issue. In fact, petitioners are at polar extremes as to what

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[472] *Associated Gas Distributors v. FERC*, 824 2d 981 (D.C. Cir. 1987). *cert. denied.*, 485 U.S. 1006 (1988) (AGD).

[473] *United Distribution Companies v. FERC*, 88 F.3d 1105 (1996) (*United Distribution Companies*).

[474] Such access may be the open access required under this rule or case-by-case transmission access ordered pursuant to FPA section 211.

the Commission should do regarding stranded costs. Some argue that the Commission has gone too far in permitting utilities to seek recovery of stranded costs, whether such costs are associated with wholesale requirements contracts, with retail-turned-wholesale customers, or with retail customers that obtain retail wheeling.[475] Others argue that the Commission has not gone far enough and that it must broaden the scope of stranded cost recovery permitted under the Rule. Indeed, some would have us be the guarantor for recovery of all uneconomic costs that might be stranded in the move to more competitive markets, no matter how tenuous the nexus to this Rule, and irrespective of state-Federal jurisdictional complexities. Some support the Commission's decision to recover stranded costs directly from the departing customers. Others would prefer that the Commission require utilities to absorb a portion of their stranded costs or that the Commission spread the burden of stranded costs among all of the utility's customers. Some object that the Commission's approach to stranded costs in the electric industry is different from that adopted in the gas industry. Some entities support the Commission's revenues lost approach for measuring a departing customer's stranded cost obligation. Others propose different methods for computing stranded costs.

Given the plethora of positions that entities have raised both initially and on rehearing concerning stranded costs, the

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[475] We note that the regulations implementing this rule use "wholesale stranded cost" and "retail stranded cost" as shorthand terms to refer to the different situations in which a utility may experience stranded costs. However, as the definitions of those terms make clear, it is *not* the nature of the *costs* (wholesale vs. retail) that is controlling for purposes of stranded cost recovery under this Rule. Rather, the controlling factors are the status of the *customer* (wholesale transmission services customer vs. retail transmission services customer) with whom the costs are associated, and whether the transmission tariffs used by the customer to escape its former power supplier (thus causing the stranding of costs to occur) were required by this Commission or by a state commission. As a result, "retail stranded costs" refers to stranded costs associated with retail wheeling customers.

Commission has taken a careful, measured approach with regard to stranded cost recovery. The Commission has balanced a number of important interests in order to achieve what it believes will be fair and orderly transition to competitive markets. These interests include the financial stability of the electric utility industry, upholding the regulatory bargain under which utilities made major capital investments, and not shifting costs to customers that had no responsibility for causing those costs to be incurred. The Commission also has adopted an approach that, for purposes of stranded cost recovery from wholesale transmission customers, relies on the nexus between stranded costs and the use of transmission tariffs required by this Commission and, for purposes of stranded cost recovery from retail customers, recognizes state commission jurisdiction but fills potential regulatory gaps that could arise in the transition to new market structures.

The balancing of interests and considerations described above is reflected in the following central components of the Rule's stranded cost provisions, which are reaffirmed herein.[476] First, the Commission has determined that the most reasonable, legally supportable approach is one that permits utilities to seek recovery of wholesale stranded costs under this Rule (whether the stranded costs are associated with a departing wholesale requirements customer or with a retail-turned-wholesale customer) only in those cases in which there is a *direct nexus* between the availability and use of Commission-required transmission access[477] and the stranding of costs. In order for the

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[476] We reaffirm below our basic determinations, but make certain clarifications on limited issues, and grant rehearing on the municipal annexation issue.

[477] As we explain below, by "Commission-required transmission access" we mean the open-access transmission required under this rule or required pursuant to a section 211 order, as well as transmission provided prior to Order No. 888 (and not pursuant to a section 211 order) where such

utility to be eligible to seek recovery of stranded costs from a departing customer, the customer must have obtained access to a new generation supplier through the use of the former supplying utility's Commission-required transmission tariff (i.e., its open-access tariff or a tariff ordered pursuant to FPA section 211), not through the use of another utility's transmission system.

Other cost recovery issues are more appropriately addressed outside the context of this Rule. For example, the Rule is *not* intended to apply to costs associated with the normal risks of competition, such as self-generation, cogeneration, or loss of load, that do not arise from the new, accelerated availability of Commission-required transmission access. If a customer leaves its utility supplier by exercising options that could have been undertaken prior to mandatory transmission under Order No. 888 or the Energy Policy Act, or that do not rely on access to the former seller's transmission, there is no direct nexus to Commission-required transmission access and thus no opportunity for stranded cost recovery under the Rule.

Second, the Commission has limited the opportunity to seek stranded cost recovery under the Rule primarily to two discrete situations: (1) costs associated with customers under wholesale requirements contracts executed on or before July 11, 1994 (referred to in the Rule as "existing wholesale requirements contracts") that do not contain an exit fee or other explicit stranded cost provision; and (2) costs associated with retail-turned-wholesale customers. With regard to the existing wholesale requirements contracts, the Commission also has made a finding that it is in the public interest to permit amendments to add stranded cost provisions to these contracts, even if they

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transmission was provided on a case-by-case basis to comply with the Commission's comparability requirement. *See* note 484 *infra*.

contain *Mobile-Sierra* clauses, if case-by-case evidentiary burdens are met. We do not interpret the *Mobile-Sierra* public interest standard as practically insurmountable in extraordinary situations such as this one where historic statutory and regulatory changes have converged to fundamentally change the obligations of utilities and the markets in which they and their customers will operate.

Third, Order No. 888 *does not guarantee* that a utility will be allowed to recover stranded costs. Rather, it provides an *opportunity* for such recovery. To be eligible to recover stranded costs from a departing customer in a particular case, the utility must demonstrate that it incurred costs to provide service to the customer based on a reasonable expectation of continuing service to that customer beyond the contract term.[478] In the case of stranded costs associated with wholesale requirements contracts customers, if the contract contains a notice of termination provision, that provision is strong evidence that the parties were aware that at some point in the future the customer might seek to find another supplier. Therefore, there is a rebuttable presumption of no reasonable expectation, and therefore no opportunity for stranded cost recovery unless the utility can overcome the presumption.

The Commission has concluded that direct assignment of stranded costs to the departing customer (through either an exit fee or a surcharge on transmission) is the appropriate method for recovery of stranded costs under the Rule. In reaching this conclusion, the Commission carefully weighed the arguments supporting direct assignment of stranded costs against those supporting a more broad-based approach, such as spreading

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[478] We have made a minor revision to the regulatory text, section 35.26(c)(2), to conform the language of that section with sections 35.26(b)(1) and (5). A conforming revision has been made to section 35.26(d)(2)(i).

stranded costs to all transmission users of a utility's system, and also took into account the fact that we applied a different approach in the natural gas area. The central considerations that support a direct assignment approach in the electric industry are that the approach follows the traditional regulatory concept of cost causation, it avoids shifting costs to customers that had no responsibility for causing them to be incurred or for causing them to be stranded, and it is still possible to apply such an approach at this stage of the industry's evolution.

There is no question that, without the stranded cost recovery mechanism, some customers would be far more likely to switch to lower-cost suppliers and enjoy sooner the benefits of a competitive power market. But, as detailed in Order No. 888, such an approach may result in higher costs for other customers. We thus have had to balance the potential for earlier benefits for some customers against other public interest considerations, most particularly the need to provide a fair mechanism by which utilities can recover the costs of past investments under traditional regulatory concepts of prudently incurred costs and cost causation. The result is not to deny competitive advantages, but only to delay their full realization for some customers so that all customers ultimately will benefit.

While Order No. 888s cost causation approach is different from the Order No. 636 cost spreading approach that was affirmed in the *United Distribution Companies* case, we believe it is the preferable approach given the early stage of the electric utility's competitive transition. We do not read the court's opinion as precluding the Commission from adopting a direct assignment approach in Order No. 888, particularly where, as here, the Commission has fully explained and justified the reasons for following traditional cost causation principles. In addition, although the *United Distribution Companies* court remanded for further consideration (in light of Order No. 636's cost spreading approach) the decision not to require any pipeline absorption of gas supply realignment costs, the Commission has fully explained how its decision in Order No. 888 not to require any utility absorption of stranded costs is consistent with its decision to follow traditional cost causation principles. With respect to the fundamental conclusion that utilities should be permitted an opportunity to recover their prudently incurred costs, Order No. 888 is fully consistent with Order No. 636. Although the Commission in Order No. 888 chose a direct assignment method (rather than the cost-spreading approach in Order No. 636) for purposes of allocating stranded cost responsibility among customers, the approach used by the Commission in Order No. 888 is not governed by decisions in Order No. 636, but in either event the Commission must demonstrate that its choice of methods is based on reasoned decision-making.

In considering the stranded cost issues that may arise in the transition to competitive markets, the Commission also has taken cognizance of significant changes involving retail customers and the stranded cost issues that arise as retail customers convert to wholesale customer status (e.g., through municipalizations) in order to obtain the open access afforded by Order No. 888, or as they obtain retail wheeling required by state commissions. These situations involve new and complex jurisdictional issues and represent the bulk of potential stranded costs facing the industry. We believe it is important to clarify the Commissions' decisions as to when it will entertain requests for stranded cost recovery in these situations, and our reasons for doing so.

The Commission's determination that it, rather than the states, should be the primary forum for addressing stranded costs associated with a retail-turned-wholesale customer[479] is limited

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[479] In Order No. 888 and here, we sometimes use the shorthand expression "retail-turned-wholesale" customer. By this we do not mean that a retail customer who is an ultimate consumer ceases to be an ultimate

to those cases in which there is a *direct nexus* between the availability and use of Commission-required transmission access and the stranding of costs. We believe we have both the authority and the obligation to provide an opportunity for stranded cost recovery in these situations because the bundled retail customer would not be able to obtain access to the new supplier *but for* the Commission's order requiring transmission. The creation of a new wholesale entity to purchase power on behalf of retail customers would not, by itself, trigger stranded costs. In the absence of transmission access from the historical supplier of the retail customers, the new entity would have to remain on the historical supplier's generation system because it would have no way to reach other power suppliers, and stranded costs would not occur.[480] Therefore, there is a casual nexus between the stranded costs and the availability and use of the

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consumer, or that this customer begins to purchase electric energy for resale. Rather, in a "retail-turned-wholesale customer" situation, such as the creation of a municipal utility system, a newly created entity becomes a wholesale power purchaser on behalf of retail customers who were formerly bundled customers of a the historical local utility power supplier. The new municipal utility is the conduit by which retail customers, if they cannot obtain direct retail access, can reach power suppliers other than their historical local utility power supplier. Although the retail customers remain bundled retail customers, in that they become the bundled customers of the new entity, we call this a "retail-turned-wholesale customer" situation because the new entity in effect "stands in the shoes" of the retail customers for purposes of obtaining wholesale transmission access and new power supply.

[480] Exceptions would be self-generation or construction by the new entity of its own transmission line, in which case, as noted earlier, the stranded cost provisions of Order No. 888 would not apply because such option have always been available as alternatives to purchasing power from the historical supplying utility and do not involve the use of the utility's transmission facilities under an open-access tariff. Thus the departure of customers under these circumstances cannot be linked to the open-access requirements of this Rule.

tariff services *required by the Commission*.[481] Moreover, because of this casual nexus between the use of a jurisdictional utility's Commission-required transmission tariff and the potential for foregone revenues by that jurisdictional utility as a result of the Commission-required access, the stranded costs associated with a retail-turned-wholesale customer are properly viewed as economic costs that are jurisdictional to this Commission.

In contrast, in the situation in which a bundled retail customer obtains retail wheeling, stranded costs are directly caused by the availability and use of unbundled retail services *required by the state commission*, not this Commission.[482] Thus, the Commission believes that states, not the Commission, should be the primary forum for costs associated with a bundled retail customer that obtains retail wheeling. The Commission's decision to entertain request to recover stranded costs caused by retail wheeling in *only* a limited circumstance (where the state regulatory authority does not have authority under state law to address stranded costs when the retail wheeling is required) is based on a policy decision by this Commission that it will step in to fill a regulatory "gap" that could result in no effective forum in which utilities would have an opportunity to seek recovery of prudently incurred costs.

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[481] As discussed in greater detail in sections IV.J.6 and IV J.12 below, we clarify that the opportunity for recovery of stranded costs in retail-turned-wholesale situation is limited to cases in which the former bundled retail customer subsequently becomes, either directly or through another wholesale transmission purchaser, an unbundled wholesale transmission services customer of its former supplier. We have revised section 35.26(b)(1)(i) of the Commission's regulations accordingly.

[482] Unbundled retail transmission services required by a state commission could be taken under the same *pro forma* open-access tariff used by wholesale customers or, if determined appropriate by the Commission, under a separate retail tariff filed at the Commission. The critical point, however, is that in either case, the unbundled services are required by the state and not by this Commission.

Finally, after considering various proposals regarding how stranded costs should be calculated, and reviewing the arguments of petitioners on rehearing, the Commission continues to believe that the revenues lost approach is the fairest and most efficient way to determine the amount of stranded cost assigned to a departing customer during the transition to a competitive wholesale bulk power market. The Commission has rejected an asset-by-asset approach as overly complicated and costly.

We respond below to the specific arguments raised on rehearing and elaborate on the above determinations.

1. Justification for Allowing Recovery of Stranded Costs

In Order No. 888, the Commission concluded that utilities should be given the opportunity to seek recovery of legitimate, prudent and verifiable stranded costs associated with a limited set of wholesale requirements contracts executed on or before July 11, 1994.[483] We stated that utilities that entered into contracts to make wholesale requirements sales under an entirely different regulatory regime should have an opportunity to recover stranded costs that occur as a result of customers leaving the utilities' generation systems through Commission-

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would affect market participants unequally. Those with long terms remaining on their contracts could object that immediately addressing the issue would not be cost effective. A utility with a long remaining term might not even seek stranded cost recovery depending on the competitive value of its assets near the end of the contract term.[671] However, such a utility would invariably seek to preserve its option to seek stranded cost recovery if its failure to do so within a short period resulted in a waiver of its right to do so. Having determined that it is generally appropriate to leave in place existing requirements contracts, it is not then reasonable to create a time limitation on stranded cost recovery that would encourage a supplier to seek early termination in order to preserve its stranded cost recovery rights.

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[483] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at pp. 31,788-91; *mimeo* at pp. 451-58.

On this basis, we believe that we have adequately explained the rationale for our decision to allow stranded cost claims to be raised at any time prior to the termination of the contract, instead of within three to five years of the effective date of the Rule.

6. Recovery of Stranded Costs Caused by Retail-Turned-Wholesale Customers

In Order No. 888, we concluded that this Commission should be the primary forum for addressing the recovery of stranded costs caused by a retail-turned-wholesale customer.[672] We stated that if such a customer is able to reach a new generation supplier because of the new open access (through the use of a FERC-filed open-access transmission tariff or through transmission services ordered pursuant to section 211 of the FPA), any costs stranded as a result of this wholesale transmission access should be viewed as "wholesale stranded costs." We explained that there is a clear nexus between the FERC-jurisdictional transmission access requirement and the exposure to non-recovery of prudently incurred costs and that, in these circumstances, this

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[671] The value of its assets could vary over time as new technologies emerge, fuel costs fluctuate, or environmental requirements change.

[672] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at pp. 31,818-19; *mimeo* at pp. 534-37.

Commission should be the primary forum for addressing recovery of such costs.[673]

We said we will not be the primary forum for stranded cost recovery in situations in which an existing municipal utility annexes territory served by another utility or otherwise expands its service territory. We indicated that in these situations there is no direct nexus between the FERC-jurisdictional transmission access requirement and the exposure to non-recovery of prudently incurred costs. The risk of an existing municipal utility expanding its territory was a risk prior to any open-access requirement.

Nevertheless, we did express concern that there may be circumstances in which customers and/or utilities could attempt, through indirect use of open-access transmission, to circumvent the ability of any regulatory commissions—either this Commission or state commissions—to address recovery of stranded costs. We reserved the right to address such situations on a case-by-case basis.

Rehearing Requests Opposing Retail-Turned-Wholesale Jurisdiction

A number of entities challenge the Commission's assertion that costs associated with retail-turned-wholesale customers would not be stranded but for the FERC-jurisdictional transmission access requirement. They assert that the condition precedent to municipalization is the operation of a state process, and thus that it cannot be the case that the recovery of costs caused by a retail-turned-wholesale customer is "not subject to regulation by the States." They submit that such costs would not be stranded but for the action of state legislators or state regulators in granting authority for the customer's status change. They argue that any nexus that the Commission's authority under the FPA has to wholesale transmission services subsequently provided to the new wholesale customer is entirely derivative of the state's action.[674]

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[673] We indicated that we will require the same evidentiary demonstration for recovery of stranded costs from a retail-turned-wholesale customer (and will apply the same procedures for determining stranded cost obligation) as that required in the case of a wholesale requirements customer.

A number of entitles argue that jurisdiction over costs that are stranded when a retail customer becomes a wholesale customer should be left to the states because the facilities used to provide retail service to these retail customers were subject to state jurisdiction and were included in retail rate base when the service was rendered.[675] They argue that because the Commission had no jurisdiction over the public utility facilities and costs incurred to serve retail-turned-wholesale customers, it has no jurisdiction to address those public utility costs if they become stranded. Thus, according to these entities, the conversion of the customer from retail to wholesale does not simultaneously effectuate a conversion of the costs from retail to wholesale.

AR Com and MO/KS Coms submit that jurisdiction over the costs incurred for historical retail customers does not shift unless the parties themselves make those costs a part of their new wholesale contract. NY Com submits that the Commission should recognize the states' jurisdiction to set the level of stranded costs associated with retail-turned-wholesale customers to be recovered in wholesale transmission rates set by FERC. FL Com asserts that state authorities are in a better position to

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[674] *E.G.*, NARUC, TAPS, Nucor, Suffolk County, IL Com, Multiple Intervenors, APPA, CAMU, WI Com, NASUCA.

[675] *E.g.*, ELCON, IL Com, IN Com, American Forest & Paper, AR Com, MO/KS Coms, NJ BPU, Suffolk County, WY Com, VA Com, FL Com, NARUC, TAPS.

assess the extent of stranded facilities and their costs, and that the Commission's involvement should be limited to that requested by a state by petition.

OH Com states that the Commission's position on stranded costs associated with retail-turned-wholesale customers invites second-guessing of state commission determinations and encourages forum shopping by introducing more than one stranded cost treatment within a single state jurisdiction. It expresses concern that utilities may seek to creatively disaggregate into generation, transmission, and distribution companies in ways to deliberately recast traditional retail relationships as wholesale in an effort to obtain favorable regulatory treatment of stranded costs.

IN Com submits that Order No. 888's treatment of stranded costs associated with retail-turned-wholesale customers will discourage state legislatures from making municipalization more available. VT DPS and Valero argue that the threat of a stranded cost surcharge will erect a new barrier to the formation of municipal utilities. They note that the rule refers to one commenter's observation that, if Otter Tail could have made a stranded cost claim against the municipal utility that Elbow Lake planned to create, Otter Tail would not have needed to refuse to wheel and there would never have been an *Otter Tail case*. They submit that the Commission never addressed whether, or why, it believed the point to be wrong.

VT DPS and Valero also assert that the rule represents a major inconsistency with prior Commission treatment of municipalization. They submit that the Commission historically promoted franchise competition between municipalities and utilities by holding tariff provisions that restrict such competition to be anticompetitive and unreasonable.[676]

American Forest & Paper submits that recover of 100 percent of stranded costs caused by municipalization is inconsistent with the Commission's actions in the natural gas industry, where the Commission has encouraged competition at the retail level through competitive bypass and has not created barriers to competitive entry by imposing transition charges or exit fees on converting customers.[677]

Nucor objects that the rule does not address the substantive findings, the common sense rationale, or the jurisdictional distinction drawn in *United Illuminating*.[678] It contends that the Commission's observation in Order No. 888 that there may not be a state regulatory forum for the recovery of stranded costs associated with retail-turned-wholesale customers and hence that the Commission should be the primary forum for addressing such stranded costs is flawed because there always is a state forum to address such cost recovery (the adequacy of the relief provided is a very distinct issue) and open-access transmission does not and cannot cause retail competition to occur.[679]

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[676] VT DPS and Valero cite in this regard *Florida Power & Light Company*, 8 FERC ¶ 61,121 (1979); *Power Authority of the State of New York v. FERC*, 743 F.2d 93 (2d Cir. 1984); *Metropolitan Transportation Authority v. FERC*, 796 F.2d 584 (2d Cir. 1986).

[677] American Forest & Paper cites in support of its position *Great Lakes Gas Transmission Limited Partnership*, 68 FERC ¶ 61,376 (1994).

[678] *United Illuminating Company*, 63 FERC ¶ 61,212, *reh'g denied*, 64 FERC ¶ 61,087 (1993) (*United Illuminating*).

[679] *See also* Suffolk County Rehearing (Commission's analysis in *United Illuminating* was correct: nothing has changed to warrant the Commission's rejection of that analysis).

Commission Conclusion

We will reject the requests for rehearing of our decision to be the primary forum for addressing the recovery of stranded costs caused by retail-turned-wholesale customers. We find the requests for rehearing on this issue unpersuasive. While it may be the case, as some entities suggest, that state action is a condition precedent to municipalization, the rehearing petitions ignore the fact that the rule covers situations in which open access is *also* a condition precedent to the municipalized customers leaving their existing supplier's system. Order No. 888 does not propose that the Commission be the primary forum for stranded cost recovery for all cases of municipalization. Instead, our holding is limited to those cases in which the new wholesale entity uses Commission-mandated transmission access to obtain new power supply on behalf of retail customers that were formerly supplied power by the utility providing the transmission service.[680]

As we explained in Order No. 888, in such cases there is a direct nexus between the FERC-jurisdictional transmission access requirement and the exposure to non-recovery of costs stranded as a result of this wholesale transmission access. Thus, the stranded costs associated with retail-turned-wholesale customers for which Order No. 888 provides an opportunity for recovery would not have been incurred but for the action of this Commission in requiring a utility to make unbundled transmission services available. In these cases, the former bundled retail customers of the historical supplying utility (now the bundled retail customers of the new municipal system) would not have obtained access to new power supply but for the Commission's order mandating transmission. Without the regulatory mandate to provide access, the utility would have indirectly continued sales to the same retail customers because the new municipal utility purchasing power on the retail customers' behalf would have had no way to reach other power suppliers. In this situation, there would be no stranded generation costs. In other words, the creation of a municipal utility intermediary to purchase power at wholesale would not, by itself, trigger stranded costs. Rather, it is the access from the historical supplier of the bundled retail customers that is the condition precedent to reaching other power suppliers and thereby triggering stranded costs. Therefore, there is a clear causal nexus between the stranded costs and the availability and use of the tariff *required by the Commission.*

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[680] In the case of municipalization, the bundled retail customers of a local utility become the bundled retail customers of the new municipal utility. As explained above, we call this a "retail-turned-wholesale customer" situation because the new municipal entity in effect "stands in the shoes" of the retail customers for purposes of obtaining wholesale transmission access and new power supply.

Costs that are exposed to nonrecovery when a retail customer or a newly-created wholesale power sales customer ceases to purchase power from the utility and *does not* use the utility's transmission system to reach a new generation supplier (e.g., through self-generation or use of another utility's transmission system) do not meet the definition of "wholesale stranded costs" for which the rule provides an opportunity for recovery. Such costs are outside the scope of the rule because such costs would not be stranded as a direct result of the new open access.

In response to the argument that conversion of a customer from retail to wholesale would not simultaneously effectuate a conversion of the costs from retail to wholesale, we believe this argument confuses the issue. We note that we have defined stranded costs as wholesale or retail on the basis of whether wholesale or retail open access is the cause of the costs being stranded, not on the basis of the original retail or wholesale characteristic of the costs. Thus, even though costs may have been originally incurred as retail-related costs, the precipitating event that results in such costs being stranded in the retail-turned-wholesale customer scenario is the use by the new wholesale customer of the Commission-mandated tariff. When a customer is able to use the Commission-required tariff to reach another generation supplier, it causes the utility to incur an economic cost in providing transmission service that is equal to the foregone revenues that the utility reasonably expected to receive under a state regulatory regime. Thus, because of the causal nexus between the use of a former supplying utility's Commission-mandated transmission tariff and the potential for foregone revenues by that utility as a result of the Commission-required access, the costs stranded by a retail-turned-wholesale customer are properly viewed as economic costs that are jurisdictional to this Commission.

In response to those entities that express concern that the Commission's position on stranded costs associated with retail-turned-wholesale customers invites second-guessing of state commission determinations, we emphasize that we have assumed primary authority to address such costs only in a limited category of cases where there is a direct nexus between the availability of Commission-required open access and the stranding of costs when the former customer uses the former supplying utility's transmission system (through its open-access tariff or a section 211 order) to reach a new supplier. We indicated in Order No. 888 that if the state has permitted any recovery from departing retail-turned-wholesale customers, such amount will not be stranded for purposes of this Rule. We will deduct that amount from the costs for which the utility will be allowed to seek recovery under this rule from the Commission. In so doing, however, we are not second-guessing the states as to what a utility may recover under state law. Additionally, we will give great weight in our proceedings to a state's view of what might be recoverable.

We also reject the argument that the Commission's position on stranded costs associated with retail-turned-wholesale customers encourages forum shopping. To the contrary, as we said in Order No. 888, to avoid forum shopping and duplicative litigation of the issue, we expect parties to raise claims before this Commission in the first instance. We believe that this Commission should be the primary forum because, without the open access provided by the Rule, the new municipal utility would not be able to reach a new supplier and, as a result, would not cause the utility to incur stranded costs (as defined in this Rule).

We reject as misplaced arguments that the rule represents a major inconsistency with the Commission's historical promotion of franchise competition between municipalities and utilities and that it will discourage municipalization.[681] It continues to be the Commission's policy to encourage competition. Indeed, the goal of Order No. 888 is to remove impediments to competition in the wholesale bulk power marketplace and to bring more efficient, lower cost power to the Nation's electricity consumers. However, the purpose of the stranded cost policy is neither to encourage nor to discourage municipalization, but rather to facilitate a fair transition to competition and to ensure stability in the industry during that transition. As we discuss elsewhere in this order, we believe that this Commission must address the recovery of the costs of moving from a monopoly-regulated regime to one in which all sellers can compete on a fair basis and

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[681] In response to VT DPA and Valero, we note that whether or not Otter Tail may have agreed to wheel power for the municipal utility that Elbow Lake planned to create if Otter Tail could have made a stranded cost claim against that municipal utility is of no moment to the Commission's decision in Order No. 888 to allow utilities the opportunity to seek recovery of stranded costs associated with retail-turned-wholesale customers. The Court in *Otter Trail* did not address the stranded cost issue because it was not presented in that case. Nor was the Court presented with the extraordinary circumstances—the historic statutory and regulatory changes, including the requirement of open-access, that have converged to fundamentally change the obligations of utilities and the markets in which they operate—that have justified this Commission's Order No. 888 stranded cost policy.

in which electricity is more competitively priced. On this basis, we believe that if a new wholesale entity such as a municipal utility uses Commission-required open access to reach a new supplier on behalf of its retail customers (previously retail customers of the former supplier), the former supplying utility should be given an opportunity to recover legitimate, prudent and verifiable costs that it incurred under the prior regulatory regime to serve that customer.

In response to American Forest & Paper's argument that recovery of 100 percent of stranded costs caused by municipalization is inconsistent with the Commission's policy in the natural gas industry of allowing competitive bypass without imposing transition charges or exit fees on converting customers, we note that industrial gas customers who bypass a local distribution company's (LDC) facilities do not escape transition costs quite so easily as suggested by American Forest & Paper. It is true that, when the end-user bypasses the LDC to reach an interstate pipeline different from the pipeline serving the LDC, the Commission views the bypass as a risk of competition from which the LDC should not be shielded.[682] However, when the end-user bypasses the LDC to reach the same interstate pipeline that serves the LDC, the Commission may take certain actions to minimize adverse effects on the LDC and its remaining customers.[683] Moreover, an end-user that bypasses an LDC to reach the same pipeline that serves the LDC would, in any event, be allocated a share of the pipeline's gas supply realignment costs (if any), since those costs are allocated based on current contract demand (or usage).[684] Accordingly, we see no inconsistency between our bypass policy for the natural gas industry and Order No. 888's treatment of stranded costs associated with retail-turned-wholesale customers. Similar to our refusal to shield LDCs from the adverse effects of an end-user's bypass to reach a different pipeline than serves the LDC. Order No. 888 does not provide an opportunity for stranded cost recovery where a retail-turned-wholesale customer uses another utility's transmission system to reach a new supplier. As we noted above, the opportunity for recovery of stranded costs associated with retail-turned-wholesale customers is limited to those cases in which the former retail customer obtains (either directly or through another wholesale transmission purchaser) unbundled transmission services from its former supplying utility. In the case of an end-user customer bypassing the LDC to reach the same pipeline that serves the LDC, the end-use customer would similarly be allocated a share of the pipeline's gas supply realignment costs. As a result, American Forest & Paper's attempt to rely on the Commission's gas bypass policy is misplaced.

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[682] *Texas Gas Transmission Corporation*, 65 FERC ¶ 61,275 (1993).

[683] *Texas Gas Transmission Corporation*, 69 FERC ¶ 61,245, *reh'g*. 70 FERC ¶ 61,207 (1995) (requiring pipeline to offer LDC a reduction in its contract demand).

We also disagree with those entities that argue that the Commission has failed to adequately distinguish Order No. 888's treatment of stranded costs associated with retail-turned-wholesale customers with the Commission's decision in *United Illuminating*. As we stated in Order No. 888, we recognize that we took a different approach to stranded cost recovery associated with retail-tuned-wholesale customers in *United*

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[684] *See Southern Natural Gas Company* 75 FERC ¶ 61,046, at p. 61,158 (1996); *Arcadian Corporation v. Southern Natural Gas Company*, 67 FERC ¶ 61,176, at p. 61,538 (1994). *See also United Distribution Companies*, 88 F.3d at 1181. As the *United Distribution Companies* court noted, the Commission has given an LDC relief (and required the bypassing customer to bear its share of transition costs) if the LDC can show a direct nexus between the bypass and the pipeline, although the Commission has declined to adopt a generic rule addressing this issue. 88 F.3d at 1180-81.

Illuminating, where we suggested that state and local regulatory authorities or the courts should be able to provide an adequate forum to address retail franchise matters, including recovery of stranded costs caused by municipalization, but said we would consider revisiting the question if United Illuminating could demonstrate the lack of a forum.[685] However, we explained that since the issuance of that decision we have had an opportunity to re-analyze the nature of the stranded cost problem when a retail customer becomes a wholesale customer, including the potential that there might not be a state regulatory forum for recovery of such costs. In these circumstances, we have determined that where such costs are stranded as a direct result of Commission-mandated wholesale transmission access, these costs should be viewed as costs of the transition to competitive wholesale bulk power markets and this Commission should be the primary forum for addressing their recovery.

In response to Nucor's objection that there always is a state forum to address stranded costs recovery associated with retail-turned-wholesale customers, with the adequacy of the relief being a distinct issue, we clarify that our primary concern in retain-turned-wholesale situations is not whether there is an adequate state regulatory forum for the recovery of stranded costs associated with retain-turned-wholesale customers. Rather, our primary concern is that wholesale customers (whether or not formerly retail) should be responsible for the costs incurred to meet their power needs that are stranded when they use the wholesale transmission ordered by this Commission to reach new suppliers. Our decision to be the primary forum in the case of stranded costs associated with retail-turned-wholesale customers is based on the causal nexus between regulatory-mandated wholesale transmission access and the stranding of costs when a new municipal utility uses such access to obtain new power supply on behalf of retail customers previously served by the former supplying utility.

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[685] 63 FERC at pp. 62,583-84.

Rehearing Requests Seeking Expansion of Retail-Turned-Wholesale Jurisdiction

Other entities seek rehearing of the Commission's decision not to be the primary forum for stranded cost recovery in situations in which an existing municipal utility annexes territory served by another utility or otherwise expands its service territory.[686] A number of them argue that the loss of existing retail customers through municipal annexations or expansions is no different from the loss of retail customers through new municipalization because existing municipal systems are likely to use Commission-jurisdictional open-access transmission to obtain resources to supply power to the annexed loads.[687] They submit that, just as with newly-municipalized customers, such costs would not be stranded but for the action of this Commission.

Some of these entities express concern that the rule will encourage retain-turned-wholesale transactions to be undertaken as annexations rather than through the formation of new entities to avoid stranded costs.[688] Public Service Co of CO contends

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[686] *E.g.*, EEI, SoCal Edison, Centerior, Atlantic City, PSE&G, Puget, Public Service Co of CO, Coalition for Economic Compeition.

[687] *E.g.*, EEI, SoCal Edison, PSE&G, Puget, Public Service Co of CO, Coalition for Economic Competition, Coalition for Economic Competition suggests, for example, that villages and large industrial customers may opt to join existing municipal systems that, in most cases, will use Commission-jurisdictional transmission tariffs to obtain resources to supply power to the annexed loads.

[688] *E.g.*, EEI, Coalition for Economic Competition, Atlantic City, Puget, Public Service Co of CO.

that Order No. 888, in conjunction with the Commission's section 211 order in *American Municipal Power Ohio, Inc.*,[689] may facilitate municipal annexations by enabling municipal systems to serve new territory through the establishment of second delivery points.

Coalition for Economic Competition and Puget also argue that the Commission must consider stranded costs that arise from municipal expansion in order to satisfy its statutory obligation under the FPA to "set just and reasonable" rates. They contend that there is no justification for charging one rate to former retail customers taking transmission services through a new municipal utility and another rate to those taking service through municipal annexation or through use of another utility's transmission system.

PSE&G suggests that the distinction between new municipalization on the one hand and municipal annexation or expansion on the other hand may lead to unnecessary controversy and litigation as entitles wrangle over whether a given expansion/annexation is really an expansion or a municipalization. It says that a situation could arise where a municipality serves one town in order to serve thousands of additional customers in a second town. According to PSE&G, it is not clear from the rule whether the Commission would consider this an expansion of a municipality's service territory or a new municipalization.

Puget submits that the stranded cost recovery mechanism must not be subject to being frustrated by simple artifices such as having the new supplier (instead of the departing customer) request and contract for transmission service. SoCal Edison seeks clarification of the Commission's authority to mandate stranded cost recovery if a retail customer disconnects from a utility's system and accesses another generation supplier by interconnecting with a public power entity (who in turn would interconnect with a neighboring jurisdictional utility). It asks the Commission to clarify that such a transaction effectively constitutes a municipalization, not an expansion of a service territory, and that the Commission, under FPA section 211, can compel the recovery of stranded costs by having the "new" jurisdictional utility assess a stranded cost charge and pass the revenues on to the utility from whose system the customer departed.

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[689] 74 FERC ¶ 61,086, *final order directing transmission service*, 76 FERC ¶ 61,265 (1996).

SoCal Edison seeks several additional clarifications. It states that it understands that the Commission's primary forum status in no way prevents or interferes with a state's authority to order stranded cost recovery from departing retail customers. If this is not the case, SoCal Edison seeks rehearing on this issue. SoCal Edison also seeks the Commission to clarify that the Commission retains the discretion to defer to a state stranded cost calculation methodology if appropriate to do so on the facts of a particular case.

Commission Conclusion

We have carefully reviewed the arguments made by petitioners seeking rehearing of our decision not to be the primary forum for stranded cost recovery in the case of municipal annexations. Based on that review we have decided to reconsider our decision. This conclusion is based in large part upon the very significant similarities between the creation of a *new* municipal utility system (also referred to as municipalization) and the expansion of an *existing* municipal utility system (*e.g.*, through annexation of additional retail service territory). We recognize that the same nexus to Commission-required transmission access that forms the basis for

our decision to allow a utility to seek stranded cost recovery in cases of new municipalization—use of the former supplying utility's transmission system—is likely to be present in some cases of municipal annexation. In the case of both new municipalizations and annexations, the bundled retail customers of a local utility become the bundled retail customers of a municipal utility (in one case a new municipal utility, in the other an existing municipal utility) *that will use the transmission system of the retail customers' former supplier in order to access other suppliers.*

As we explain above, in a "retail-turned-wholesale customer" situation, such as the creation of a municipal utility system, a newly-created entity becomes a wholesale power purchaser on behalf of the retail customers. It is the conduit by which retail customers, if they cannot obtain direct retail access, can reach power suppliers other than their historical local utility power supplier. Although the retail customers remain bundled retail customers, in that they become the bundled customers of the new entity, we call this a "retail-turned-wholesale customer" situation because the new entity in effect "stands in the shoes" of the retail customers for purposes of obtaining wholesale transmission, access and new power supply. The same analogy applies to newly annexed customers; they become "new" wholesale customers in the sense that the wholesale entity obtains transmission and new power supply on their behalf.

Accordingly, we clarify that this Commission will be the primary forum for addressing the recovery of stranded costs if an existing municipal utility uses the transmission system of its annexed retail customers' former supplier to access new suppliers to serve the annexed load. As long as Commission-required transmission access (the former supplier's open-access tariff or transmission services ordered under FPA section 211) is the vehicle that enables an existing municipal utility to obtain power supplies to serve annexed loads, we believe that any costs stranded as a result of this wholesale transmission access are properly viewed as economic costs that are jurisdiction to this Commission. In such a case, the bundled retail customers that are annexed by an existing municipal utility would, through the municipal utility, use the transmission system of their former supplier to obtain access to new supplies and thereby expose their former supplier to non-recovery of prudently incurred costs. As in the case of new municipal systems that use the transmission system of their retail customers' former supplier, such costs would not be stranded but for the action of this Commission in requiring a utility to make unbundled transmission services available.[690]

Just as we will not be the primary forum for stranded cost recovery for *all* new municipalizations, so also we will not be the primary forum for stranded costs recovery for *all* cases of municipal annexation. Instead, our holding is limited to those cases in which the existing municipal system uses Commission-mandated transmission access from the annexed customers' former supplying utility to obtain power from a new supplier. Costs that are exposed to nonrecovery when an existing municipal utility *does not* use the transmission system of the retail customers' former supplier to reach a new generation supplier (*e.g.*, through self-generation or use of another utility's transmission system) do not meet the definition of "wholesale stranded costs" for which the rule provides an opportunity for recovery. Such costs are outside the scope of the rule because such costs would not be stranded as a direct result of Commission-required transmission access.

We reject as misplaced the argument that the Commission, by failing to address costs that arise if a municipal utility (whether a *new* municipal utility or an existing municipal utility that annexes additional retail customer territory) does not use the historical supplying utility's transmission system, has not met its statutory obligation to "set just and reasonable" rates. The Commission in this rulemaking has not determined any utility's just and reasonable rates. Further, Order No. 888 does not by its terms bar the recovery of costs that do not result from the use of Commission-required transmission access. Utilities may, as before, seek recovery of such non-open-access-related costs on a case-by-case basis in individual rate proceedings. The Commission will not prejudge those issues here.

As we indicated in Order No. 888, we also are concerned that there may be circumstances in which customers and/or utilities could attempt, through indirect use of open-access transmission, to circumvent the ability of any regulatory commission—either this Commission or state commissions—to address recovery of stranded costs.[691] We reiterate that we reserve the right to address such situations on a case-by-case basis.

We share the concern expressed by Puget that a retail-turned-wholesale customer should not be allowed to avoid any stranded cost obligation that it may have under Order No. 888 simply by having its new supplier be the entity that requests and contracts for transmission service from the former supplying utility. We clarify that the opportunity for recovery of stranded costs associated with retail-turned-wholesale customers under Order No. 888 applies if the transmission system of the former supplier is used to transmit the newly obtained power supplies to the departing retail customer, regardless of whether the customer or its new supplier is the actual entity that requests and contracts for the unbundled transmission service. We have revised the definition of "wholesale stranded cost" in section 35.26(b)(1)(ii) accordingly to include the situation in which the retail customer subsequently becomes, either directly or through another wholesale transmission purchaser, an unbundled wholesale transmission services customer of the former supplying utility.

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[690] SoCal Edison requests clarification that a transaction in which a retail customer disconnects from a utility's system and accesses another generation supplier by interconnecting with a public power entity, who in turn would interconnect with a neighboring jurisdictional utility, constitutes a municipalization, not an expansion of a service territory. Because we have decided to treat municipal annexations (or expansions) and new municipalizations similarly for purposes of stranded cost recovery under the Rule. SoCal Edison's request is moot to the extent, that it envisions a scenario in which the former supplier's transmission system is used to access a new generation supplier. However, as discussed below, the rule would not provide an opportunity to seek recovery of stranded costs if the municipal entity in the scenario described by SoCal Edison *dose not* use the former supplier's transmission system.

[691] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at p. 31,819; *mimeo* at pp. 536-37.

We clarify in response to SoCal Edison's request that our decision to be the primary forum for recovery of stranded costs from retain-turned-wholesale customers is not intended to prevent or to interfere with the authority of a state to permit any recovery from departing retail customers, such as by imposing an exit fee prior to creating the wholesale entity. As we indicated in Order No. 888, if the state has permitted any such recovery from a departing retail-turned-wholesale customer, that amount will not in fact be stranded. Accordingly, we will deduct that amount from the costs for which the utility will be allowed to seek recovery from this Commission.[692]

We clarify in response to SoCal Edison's request that the Commission has the discretion to defer to a state stranded cost calculation methodology. However, because we recognize that state retail access plans may present questions that need to be addressed on a case-by-case basis, we will consider whether to exercise that discretion on a case-by-case basis.

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[692] *FERC Statutes and Regulations. Regulations Preambles January 1991-June 1996* at p. 31,819; *mimeo* at p. 537.

7. Recovery of Stranded Costs Caused by Retail Wheeling

In Order No. 888, we concluded that both this Commission and the states have the legal authority to address stranded costs that result when retail customers obtain retail wheeling in order to reach a different generation supplier, and that utilities are entitled, from both a legal and a policy perspective, to an opportunity to recover all of their prudently incurred costs.[693] We explained that this Commission's authority to address retail stranded costs (i.e., stranded costs associated with retail wheeling customers) is based on our jurisdiction over the rates, terms, and conditions of unbundled retail transmission in interstate commerce by public utilities, and that the authority of state commissions to address retail stranded costs is based on their jurisdiction over local distribution facilities and the service of delivering electric energy to end-users. Because it is a state decision to permit or to require the retail wheeling that causes stranded costs to occur, we decided we generally will leave it to state regulatory authorities to deal with any stranded costs occasioned by retail wheeling. The only circumstance in which we will entertain requests to recover stranded costs caused by retail wheeling is when the state regulatory authority[694] does not have authority under state law to address stranded costs when the retail wheeling is required. In such a case, we will permit a utility to seek a customer-specific surcharge to be added to an unbundled transmission rate.

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[693] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at pp. 31,824-26; *mimeo* at pp. 553-58.

[694] "State regulatory authority" has the same meaning as provided in section 3(21) of the FPA: "'State regulatory authority' has the same meaning as the term 'State commission', except that in the case of an electric utility with respect to which the Tennessee Valley Authority has ratemaking authority (as defined in section 3 of the Public Utility Regulatory Policies Act of 1978), such term means the Tennessee Valley Authority."

We noted that most states have a number of mechanisms for addressing stranded costs caused by retail wheeling. We indicated that rates for services using facilities used in local distribution to make a retail sale are state-jurisdictional, and that states will be free to impose stranded costs caused by retail wheeling on facilities or services used in local distribution. We also said that states may use their jurisdiction over local distribution facilities or services to recover so-called stranded benefits.

We stated that we believe our approach to stranded costs associated with retail wheeling customers represents an appropriate balance between federal and state interests that ensures that the rates for transmission in interstate commerce by public utilities (except in a narrow circumstance) will not be burdened by retail costs.

We expressed concern about the cost-shifting potential in a holding company or other multi-state situation, where denial of retail stranded cost recovery by a state regulatory authority could, through operation of the reserve equalization formula in a Commission-jurisdictional intra-system agreement; inappropriately shift the disallowed costs to affiliated operating companies in other states. We said that we will deal with such situations if they arise pursuant to public utility filings under section 205 or complaints under section 206. Thus, the need to amend a jurisdictional agreement to prevent stranded costs associated with retail wheeling customers from being shifted to customers in other states will be addressed on a case-by-case basis. We encouraged the affected state commissions in such situations to seek a mutually agreeable approach to this potential problem. If such a consensus solution resulted in a filing to modify a jurisdictional agreement, we indicated that we would accord such a proposal deference, particularly if other interested parties cannot reach consensus that would prevent cost shifting, we said that the Commission would ultimately have to resolve the appropriate treatment of such stranded costs.

Rehearing Requests Opposing Any Commission Involvement in Stranded Costs Associated With Retail Wheeling Customers

A number of entities dispute the Commission's statement that both it and the states have the legal authority to address stranded costs that result from retail wheeling. Central Illinois Light contends that the Commission's claim of dual jurisdiction is inconsistent with *FPC v. Southern California Edison Company.*[695] It says that the court in that case recognized that Congress meant to draw a bright line easily ascertained between state and federal jurisdiction, making unnecessary case-by-case analysis. Central Illinois Light asserts that the Commission has stepped over the bright line into the states' exclusive jurisdiction over retail rates.

IA Com seeks rehearing on the Commission's assertion of concurrent jurisdiction with state authorities over stranded costs associated with retail wheeling customers on the ground that it is based on the Commission's erroneous assertion of jurisdiction over unbundled retail transmission.

IL Com says that regardless of whether the Commission's claim of jurisdiction over retail transmission is upheld, the Commission's ruling that there is joint jurisdiction over retail stranded costs is in error. According to IL Com, the Commission has no authority over such stranded costs. IL Com also disputes the Commission's characterization of the derivation of state authority to address such stranded costs. It says that state commission authority does not derive only from states' jurisdiction over local distribution facilities and the service of commission authority to address retail stranded costs derives from the existence of state commission jurisdiction over the facilities and costs at the time of their incurrence.

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[695] 376 U.S. 205, 215-16 (1964).

A number of entities contend that Commission jurisdiction over transmission facilities used in interstate commerce does not give it jurisdiction over stranded investment in retail generating assets.[696] Several argue that the fact that a retail wheeling customer might need transmission access from its former supplier does not change the character of the costs that are stranded. They maintain that retail stranded costs are not costs of providing unbundled transmission service, but are costs associated with providing what was formerly bundled retail service, over which the Commission has no jurisdiction.[697]

Several entities argue that it is solely the action of the state that allows a given utility's retail customers to seek alternative sources of supply; therefore, there is no nexus between the Commission's wholesale transmission rule and any costs that might be stranded by a state-established customer choice regime.[698]

A number of entities submit that the provision of FPA section 201 that federal regulation is "to extend only to those matters which are not subject to regulation by the States" bars any

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[696] *E.g.*, Central Illinois Light, IN Consumer Counselor, IN Consumers, Nucor, FL Com, WI Com, VA Com, AR Com, MO/KS Com, OH Com, APPA,. For example, FL Com asserts that costs for facilities that are currently under the jurisdiction of state authorities do not become the Commission's jurisdiction because retail wheeling is instituted; in most cases, the sates approved both the construction and the cost recover for these facilities under bundled rate structures. FL Com submits that the states are in a better position to judge the extend and value of assets that may become stranded as a result of retail wheeling.

[697] *E.G.*, APPA, AR Com, MO/KS Coms, OH Com.

[698] *E.g.*, NARUC, TAPS.

attempt by the Commission to displace or supplant an admittedly legitimate exercise of state authority over retail stranded costs.[699] NASUCA submits that all state commissions have the authority to establish just and reasonable rates for the retail electric utilities in their respective jurisdictions.[700] It maintains that only state regulators are in a position to rule on the treatment of costs that were allowed in retail rates pursuant to state laws; the Commission has no knowledge or expertise regarding the specific state legal frameworks in which these costs were included in rates. NY Com argues that the Commission does not have jurisdiction to determine the rate treatment of costs devoted to retail service and, thus, lacks authority to allow recovery if a state decides to do so.

VA Com argues that section 201(b)(1) of the FPA restricts the Commission's jurisdiction to wholesale sales. It says that a departing retail customer remains a retail customer, regardless of the supplier. VA Com concludes that no portion of the transaction is a wholesale sale, and that there are no wholesale costs associated with a retail wheeling transaction.[701]

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[699] *E.g.*, NASUCA, NY Com, WY Com, NARUC. The Consumer's Utility Counsel Division of the Georgia Governor's Office of Consumer Affairs filed comments on June 24, 1996, in support of NARUC's request for rehearing on the jurisdictional issues pertaining to the recovery of retail stranded costs. While answers to request for rehearing generally are not permitted, 18 C.F.C. §385.213(a)(2) (1996), we will depart from our general rule because of the significant nature of this proceeding and will accept these comments.

[700] According to NASUCA, whether or not that authority includes a requirement that a utility receive 100 percent return on stranded costs (or something less) is a matter to be determined by the state courts and legislatures.

[701] *See also* AR Com (one retail transaction is replaced by another retail transaction; there is no wholesale transaction and no wholesale costs over which the Commission has jurisdiction).

A number of entities seek rehearing of the Commission's decision that it will entertain stranded cost claims when the state regulatory authority does not have authority under state law to address stranded costs when the retail wheeling is required.[702] NARUC submits that Congress did not intend the Commission to become involved in adjudicating legal questions regarding the breadth of state law authority granted state commissions by their legislatures. NARUC expresses concern that the Commission would second-guess a state cost recovery determination and promote forum shopping. Once a balance has been struck at the state level concerning the terms of restructuring, NARUC submits that it is inconceivable that the Commission would have either the desire or authority to second-guess a state's legislative and regulatory processes.

Several entities object that the Commission effectively would authorize recovery of stranded costs associated with a retail wheeling customer if a state legislature withholds from the state regulatory agency the authority to approve stranded cost recovery.[703] They submit that just because a state has not given its regulatory commission the authority to impose stranded costs in the case of retail wheeling does not confer jurisdiction on the Commission to impose such charges. They contend that the state legislature should be the final arbiter of state policy. IL Com submits that if a state legislature chooses not to give its state commission the authority to act on stranded costs, "that can be taken as a clear indication that the state's legislature most certainly does not want FERC to address them."[704] Central Illinois Light objects that the Commission has offered no reason why it will accept the decision of the regulatory agency, but not that of the legislature.

AMP-Ohio and Cleveland ask the Commission to clarify that its deference to the determinations of the states is to the authority of the states as exercised through state legislative bodies (and other political subdivisions with legislative authority) as well as to state regulatory bodies. They submit that if the state legislature, or a local government acting in accordance with its authority, enacts retail wheeling legislation that expressly limits the ability of its regulatory body to permit recovery of stranded costs, even barring all such recovery, the Commission should not become involved.

Several entities ask the Commission to clarify that Order No. 888 does not permit utilities to apply to the Commission for recovery of stranded costs associated with a retail wheeling customer when a state regulatory authority has "addressed" a request for the same stranded costs but has not allowed 100 percent recovery,[705] ELCON gives two hypothetical examples to which it asks the Commission to respond; one where a state regulatory authority possesses full stranded cost recovery authority but allows only 50 percent recovery; the other where the state legislature provides the state regulatory authority by statute with the power to permit recovery of up to 50 percent of identified stranded costs.

Commission Conclusion

We reaffirm our conclusion that both this Commission and the states have the legal authority to address stranded costs that result when retail customers obtain retail wheeling in interstate commerce from public utilities in order to reach a different generation supplier, but that, because it is a state decision to permit or require the retail wheeling that causes retail stranded costs to occur, we will leave it to state regulatory authorities to deal with any stranded costs occasioned by retail wheeling. The only circumstance in which we will entertain requests to recover stranded costs caused by retail wheeling is when the state regulatory authority does not have authority under state law to address stranded costs when the retail wheeling is required.

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[702] *E.g.*, NARUC, Central Illinois Light, IN Com, American Forest & Paper, IN Consumer Counselor, IN Consumers, IL Com.

[703] *E.g.*, Central Illinois Light, IN Com, American Forest & Paper, IN Consumer Counselor, IN Consumers, IL Com, TX Com considers that it has the power to address stranded cost issues related to retail transmission service.

[704] IL Com at p. 38 (emphasis in original).

[705] *E.g.*, ELCON, NASUCA, IL Com. NY Com.

We will reject the requests for rehearing that oppose any Commission involvement in stranded costs associated with retail wheeling customers. We disagree with those entities that challenge our conclusion that both this Commission and the states have the legal authority to address stranded costs that result from retail wheeling (variously described by those entities as dual, concurrent, or joint jurisdiction). The Commission explained in detail in Order No. 888 the legal basis for concluding that this Commission and the state commissions each have jurisdiction over separate aspects of a retail wheeling transaction.[706] This Commission has jurisdiction over the rates, terms, and conditions of unbundled retail transmission in interstate commerce by public utilities. State commissions have jurisdiction over local distribution facilities and the service of delivering electric energy to end-users. Based on our respective jurisdictions over separate aspects of the retail wheeling transaction, we believe either has the authority to provide the former supplying utility with an opportunity to recover costs stranded when the departing customer uses retail transmission in interstate commerce to reach a new supplier, but that here, unlike the retail-turned-wholesale scenario, the state commission should be the primary forum because these costs are stranded by

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[706] *See FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at pp. 31,780-85; *mimeo* at pp. 427-42 and appendix G.

the action of the state. We would act only if the primary forum is not available. We have made a policy decision that this Commission will step in to fill a regulatory "gap" that could result in no effective forum under which utilities would have an opportunity to seek recovery of prudently incurred costs.

Several entities argue that the Commission does not have jurisdiction over stranded investment in retail generating assets, that use of Commission-jurisdictional transmission does not change the character of the costs that are stranded, that stranded costs associated with retail wheeling customers are not costs of providing unbundled transmission service, but are costs associated with providing what was formerly bundled retail service, and that only state regulators are in a position to rule on the treatment of costs that were allowed in retail rates pursuant to state laws. While we agree that stranded costs associated with retail wheeling are costs that are retail in character in the sense that they are in retail bundled rates and become stranded as a result of retail wheeling required by the state commission, we do not believe this precludes the Commission from exercising jurisdiction in the limited circumstances of the Rule.

As an initial matter, we note that there are rarely separate retail and wholesale generating facilities. Retail customers and wholesale requirements customers get energy from the same facilities, each buying a "slice of the system." Typically all generating assets go into both the retail and the wholesale rate bases for determining retail and wholesale rates. Rates are determined by allocating the total generating costs among customer classes. The parties confuse the issue before us to the extent they suggest that state commissions, not this Commission have "jurisdiction" over certain "costs". Neither the state commissions nor this Commission has exclusive jurisdiction over "costs." Each regulatory authority has jurisdiction to determine "rates" for services subject to its jurisdiction and, in determining rates, may take into account all of the costs incurred by the utility. Under historical cost-of-service ratemaking, each regulatory authority, in exercising its respective *ratemaking* jurisdiction, reviews the total costs incurred by a utility to provide service and makes its separate and independent determination of what costs may be recovered through rates within its jurisdiction.[707] Generating costs continually shift between retail and wholesale rates over time.[708]

More importantly, both the state commission and this Commission have a responsibility to oversee the financial health of the utilities we regulate. Each has jurisdiction to make judgment about recovery of the costs of the assets in the utility's

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[707] If a utility is regulated by both this Commission and a state commission, each commission, in setting cost-of-service rates within its jurisdiction, will separately and independently determine the utility's *total* cost of providing service (also known as the utility's total revenue requirement). This will be based on the expenses incurred in providing service and a reasonable profit on the utility's assets that are used to provide the service. The commissions may differ as to what assets are appropriately included in total rate base, what other costs are appropriately included in the total cost of service, and what rate of return should be permitted. Once each regulatory authority has determined the appropriate total revenue requirement, it then will determine what portion of that total revenue requirement should be borne by the utility's wholesale customers and what share should be borne by retail customers (also-called cost allocation). Each commission may also reach different conclusions on this split as well. Thus, under historical cost-based ratemaking, regulatory authorities do not carve out so-called "wholesale costs" that only this Commission can take into account in determining rates subject to its jurisdiction or so-called "retail costs" that only a state commission can take into account in determining rates subject to state jurisdiction. Additionally, this Commission and state commissions have the discretion to determine whether costs are appropriately recovered through a transmission, generation, or distribution component of a rate (so-called functionalization of costs) within their respective jurisdictions.

[708] We reject arguments that stranded retail generation costs are not a cost of providing unbundled retail transmission. While such costs are not a cost of operating the physical transmission system, nevertheless, they are an economic cost incurred as a result of being required to provide retail transmission.

total rate base. Utilities are entitled to a regulatory forum that can adjudicate claims that they are or are not entitled to recovery of costs incurred regardless of the initial retail or wholesale "character" of those costs, and we believe we have the authority and obligation to fill a regulatory "gap" that could occur.[709]

In response to the argument that it is solely the action of the State that allows a retail customer to seek alternative sources of supply and, as a result, there is no nexus between the Commission's wholesale transmission rule and any costs that might be stranded by a state-established customer choice regime, we agree. Indeed, as we indicate in Order No. 888, we decided to leave it to state regulatory authorities to deal with any stranded costs occasioned by retail wheeling (with a limited exception) because it is a state decision to permit or require the retail wheeling in the first instance that causes retail stranded costs to occur. Our determination, as explained above, is to fill any regulatory gap that arises as a result of interstate wheeling. We believe that it is necessary for the Commission to act as a backstop in this limited instance to ensure that costs stranded as a result of retail wheeling do not go unrecovered because the state regulatory authority lacks the authority under state law to address such costs. At the same time, as we stated in Order No. 888, we believe that most states have a number of mechanisms for addressing stranded costs caused by retail wheeling. We emphasize that this rule is not intended to preempt the exercise of any existing state authority with respect to the assessment of a stranded cost or stranded benefits charge on a retail customer that obtains retail wheeling.

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[709] This is not a regulatory "gap" in the sense that the Commission would be asserting authority over matters not within its jurisdiction. However, the Commission would be filling a regulatory "gap" to the extent that the utility normally would have the opportunity to seek approval from its state regulatory commission to recover costs in retail rates from a departing retail customer or to reallocate those costs to other retail customers. In circumstances where the utility does not have this opportunity because the state regulatory authority has no authority to address the issue, we may appropriately fill this regulatory "gap" to permit recovery from the departing customer through the retail transmission rate.

In response to arguments that the Commission's decision will result in second-guessing or interfering with a state's legislative processes and decisions, we believe these arguments are premature. As a general matter, we do not expect that our decision to be a backstop will interfere with legislative decisions that specifically address stranded cost matters and the scope of the state regulatory authority's authority in determining stranded costs. If states or parties to a retail stranded cost recovery case brought before this Commission believe that a Commission decision on the issue would interfere with state legislative decisions, they should raise their arguments, and support therefor, at that time.

We clarify that Order No. 888 does not permit utilities to seek recovery from the Commission of stranded costs associated with retail wheeling customers if a state regulatory authority with authority to address retail wheeling stranded costs has in fact addressed such costs, regardless of whether the state regulatory authority has allowed full recovery, partial recovery, or no recovery.

Rehearing Requests Supporting Broader Jurisdiction Over Stranded Costs Associated With Retail Wheeling Customers

A number of entities seek rehearing of the Commission's decision not to serve as a backstop for all stranded costs associated with retail wheeling customers. Some assert that the Commission has the legal authority to address independently stranded costs that arise from retail wheeling and that the Commission cannot lawfully abdicate or delegate such authority

to the states.[710] Coalition for Economic Competition submits that the Commission correctly concluded that it has jurisdiction over retail transmission rates, terms and conditions and the authority to address retail wheeling stranded costs. Thus, it argues that the Commission is without the power to make a "policy determination" that results in the Commission not exercising its legal authority over stranded costs associated with retail wheeling customers. It asserts that, just as the Commission recognizes that it "cannot simply turn over its jurisdiction" to the states to determine facilities subject to Commission jurisdiction,[711] the Commission cannot turn over its jurisdiction to establish stranded cost charges that it correctly determined it has the authority to establish. Coalition for Economic Competition argues that the Commission should adopt a stranded cost recovery policy similar to the policy the Commission has adopted with respect to the determination of state/federal jurisdiction, whereby the Commission would defer to state stranded cost determination so long as they are consistent with the Commission's policy.

Utilities For Improved Transition argues that the Commission's authority over public utility rates for the transmission of electric power, both wholesale and retail, is plenary and exclusive. As a result, it submits that the Commission may not avoid responsibility for costs stranded by transmission of retail power.[712] Illinois Power contends that

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[710] *E.g.*, Utilities For Improved Transition, Coalition for Economic Competition.

[711] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at p. 31,784; *mimeo* at p. 439.

[712] Utilities For Improved Transition argues that, based on *Consolidated Edison Company of New York, Inc.*, 15 FERC ¶ 61,174, at p. 61,405 (1981) and other cases, the Commission has jurisdiction over the entire delivery service (rendered on both the transmission and local distribution facilities)

Congress did not authorize the Commission to reject jurisdictional rate filings whenever the Commission regards the state commissions as a more convenient or appropriate forum.

EEI and the Coalition for Economic Competition contend that virtually all retail stranded costs can only occur through the vehicle of Commission-jurisdictional transmission in interstate commerce. They submit that the Commission, having recognized the clear nexus between FERC-jurisdictional transmission and stranded costs in the retail-turned-wholesale context, cannot fail to recognize the same clear nexus in the retail wheeling context.

Utilities For Improved Transition says that it is legally immaterial whether stranded costs are caused by the Commission's ordering the transmission or the states' doing so; the determining factor is who has the jurisdiction to make the rates for the service, not who has the jurisdiction to order the service.

Coalition for Economic Competition and Utilities For Improved Transition contend that the Commission must consider stranded costs that arise from retail wheeling in order to satisfy its statutory obligation under the FPA to "set just and reasonable" rates. Coalition for Economic Competition maintains that FPA sections 201, 205 and 206 do not give the Commission the flexibility to allow stranded costs in certain jurisdictional wheeling rates (*e.g.*, wholesale wheeling and new municipalizations) but to exclude them from other jurisdictional wheeling rates (*e.g.*, retail wheeling, municipal annexation, and

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as a transmission transaction. Utilities For Improved Transition submits that states do not have authority over rates on local distribution facilities used to complete a transmission transaction.

bypass).[713] Utilities For Improved Transition says that the just and reasonable standard requires the Commission to backstop the states to ensure that there is full stranded cost recovery. It objects that Order No. 888's disposition of jurisdiction creates a problem of cross-class discrimination (wholesale versus retail) and interclass discrimination (some retail versus the remainder of the retail).

Coalition for Economic Competition further argues that the Commission's failure to address all stranded costs associated with retail wheeling customers will result in an improper taking under the Constitution.[714] It also argues that the Commission is not permitted to disregard its findings in Order No. 888 which, according to Coalition for Economic Competition, "inexorably" lead to the conclusion that Commission action on "all" stranded costs (including retail wheeling, municipal annexation, and bypass stranded costs) is required.[715]

Illinois Power argues that the FPA does not authorize the Commission to discriminate among utilities based on the state of their residence, and that the Commission must allow all utilities to seek interstate rate recovery of just and reasonable retail stranded costs. Illinois Power asserts that the rule will lead to the absurd, unduly discriminatory result that utilities located in states whose legislatures have failed to provide for stranded cost recovery will be better off than those located in states that provide for only limited stranded cost recovery. It supports use of the Commission's statutory authority to establish a uniform, natural method for retail stranded cost recovery.

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[713] EEI states that the Commission did not rebut EEI's argument that the Commission's failure to address all retail stranded costs was unduly discriminatory.

[714] In support of its argument, Coalition for Economic Competition cites *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591, 602 (1944); *Duquesne Light Company v. Barasch*, 488 U.S. 299, 307-08 (1989).

[715] Coalition for Economic Competition at p. 14.

Coalition for Economic Competition also contends that the Commission's decision to let the states deal with retail stranded costs is arbitrary and capricious because the Commission failed to consider the arguments that stranded cost opponents will make before state commissions, such as that a state lacks jurisdiction to impose stranded cost charges or that the state imposition of such charges may be preempted or found to be an undue burden on interstate commerce. It further argues that the Commission's reliance on state jurisdiction over the service of delivering electric energy to the end-user does not reflect reasoned decisionmaking. It submits that the Commission has failed to consider that the sale of electric energy may take place outside of the state into which the energy is transmitted, in which case the state commission may have no jurisdiction over either the sale or the transmission of the energy and, accordingly, no authority to consider stranded costs.

A number of entities ask the Commission to act on requests for retail stranded cost recovery when the state commission lacks authority or has authority to order recovery, but has declined to do so or has only allowed partial recovery.[716]

Lastly, TX Com notes that section 35.26(d) (dealing with recovery of retail stranded costs) refers only to public utilities. It suggests that the omission of a reference to transmitting utilities appears to be inadvertent and should be corrected.

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[716] *E.g.*, Centerior, Southern, SoCal Edison.

Commission Conclusion

The Commission will reject the requests for rehearing of our decision not to assume a backstop role for all stranded costs associated with retail wheeling customers. We explained in Order No. 888 that commenters that describe our action as an unlawful abdication or delegation of authority misconstrue the nature of our decision to leave stranded costs associated with retail wheeling customers (with a limited exception) to state regulatory authorities.[717] We have not "abdicated" or "delegated" to state regulatory authorities our jurisdiction over the rates, terms, and conditions of retail transmission in interstate commerce; if retail transmission in interstate commerce by a public utility occurs, public utilities offering such transmission must comply with the FPA by filing proposed rate schedules under section 205.[718] Instead, we have made a policy determination that the recovery of stranded costs associated with retail wheeling customers—an issue over which either this Commission or state commissions could exercise authority by virtue of their jurisdiction over retail transmission in interstate commerce and over local distribution facilities and services, respectively—is primarily a matter of local or state concern for which the primary forum should be the state commissions. However, if the state regulatory authority does not have authority under state law to be the forum to address stranded costs when the retail wheeling is required, then we will entertain requests to recover such costs. As we explain above in response to the rehearing petitioners that oppose any Commission involvement in stranded costs associated with retail wheeling customers, we have made a policy decision that this Commission will step in to fill a regulatory "gap" that could result in no effective forum under which utilities would have an opportunity to seek recovery of prudently incurred costs.[719]

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[717] We also explained that the case law they cite (which they refer to again in their rehearing requests) to support the proposition that an agency is not authorized to abdicate its statutory responsibility or to delegate to parties and intervenors regulatory responsibilities is factually distinguishable and inapposite. *See FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at p. 31,825 and note 765; *mimeo* at pp. 554-55 and note 765.

[718] The entities who argue that the Commissions has abdicated or delegated its jurisdiction to the states misconstrue the Commission's jurisdiction to determine rates for unbundled transmission in interstate commerce as somehow including exclusive "jurisdiction" over "costs". However, as discussed above, neither this Commission nor the state commissions has exclusive "jurisdiction" over "costs". Rather, each has jurisdiction to determine "rates" for services subject to its jurisdiction. It is in the course of determining "rates" for unbundled transmission in interstate commerce that this Commission can take into account various costs incurred by a utility to provide jurisdictional service. A state commission can take those same costs into account in making its separate and independent determinations of what costs may be recovered through rates within its jurisdiction. See note 707, *supra*, and accompanying text.

We disagree with Coalition for Economic Competition's argument that our findings in Order No. 888 "inexorably" lead to the conclusion that Commission action on "all" stranded costs (including retail wheeling and bypass stranded costs) is required, much less that the Commission has ignored the findings in Order No. 888. To the contrary, as we explain in section IV.J.I. it is not the purpose of this rule to allow utilities an opportunity to seek to recover "all" uneconomic costs that might be stranded when a customer leaves its utility supplier. We have fully explained our reasons for adopting an approach that, for purposes of stranded cost recovery from wholesale transmission customers, relies on the nexus between stranded costs and the use of transmission tariffs required by this Commission and, for purposes of stranded cost recovery from retail customers, recognizes state commission jurisdiction but fills potential regulatory gaps that could arise in the transition to new market structures.

We disagree with those entities that contend that the Commission must consider retail stranded costs in order to satisfy our statutory obligation under the FPA to set just and reasonable rates. In determining just and reasonable rates for jurisdictional transmission service, which currently are determined on a cost basis, the Commission satisfies its statutory obligation under the FPA by allowing utilities an opportunity to recover their prudently incurred costs plus a reasonable rate of return. As we have explained above, this may include the costs of use of the physical transmission system, as well as economic costs incurred by the utility when it provides transmission service (e.g., stranded costs). However, in situations in which a state regulatory authority has the authority to address recovery of retail stranded costs, there is no regulatory "gap," and there is no obligation for this Commission to provide a second opportunity for recovery.[720]

We reject arguments that FPA sections 201, 205 and 206 do not give the Commission the flexibility to allow stranded costs in certain jurisdictional wheeling rates (wholesale wheeling and new municipalizations) but to exclude them from other jurisdictional wheeling rates (retail wheeling in interstate commerce and use of another utility's transmission tariff), and that this policy somehow makes rates discriminatory. Recovery of this type of cost through a transmission rate is obviously not the norm, but is necessitated by the need to deal with the transition costs associated with this Rule. As discussed in detail in the Rule, the

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[719] Based on these same considerations, we reject Coalition for Economic Competition's request that the Commission assume a backstop role for all stranded costs associated with retail wheeling customers but defer to state stranded cost determinations so long as they are consistent with the Commission's policy.

[720] If the state regulatory authority is the forum before which to seek recovery, the utility may make whatever arguments it wishes regarding the justness and reasonableness of its rates, as well as any unconstitutional taking arguments it may have, before the state forum. Further, it can pursue appeals of unfavorable decisions through the state court system.

Commission has carefully balanced the interests of utilities as well as customers in concluding that the opportunity for stranded cost recovery through transmission rates should be permitted in only two general circumstances: (1) in the case of wholesale stranded costs, where there is a direct nexus to Commission-required transmission access; and (2) in the case of retail stranded costs, where there otherwise would be a regulatory gap because a state regulatory authority lacks authority under state law to address stranded costs at the time that retail wheeling is required. We see nothing in the FPA that precludes us from exercising this flexibility and, indeed, the parties have not pointed to anything that, in our opinion, precludes us from exercising this discretion.

We reject the argument that virtually all stranded costs associated with retail wheeling customers can occur only through the vehicle of Commission-jurisdictional transmission in interstate commerce, and therefore, that the same nexus between FERC-jurisdictional transmission and stranded costs that exists in the retail-turned-wholesale context is present in the retail wheeling context. We also disagree that it is legally immaterial whether stranded costs are caused by the Commission's ordering the transmission or the states doing so, and that the determining factor is who has the jurisdiction to make the rates for the service, not who has the jurisdiction to order the service. The opportunity for stranded cost recovery set forth in this rule is based on the causal link between stranded costs and the availability and use of the Commission-required transmission tariff. It is true that in both the retail-turned-wholesale context and the retail wheeling context there is a limited nexus between stranded costs and Commission-jurisdictional access since, in both situations, the Commission has jurisdiction over the rates, terms and conditions of the transmission service and, therefore, the authority to permit stranded cost recovery through the transmission rates. However, the *causal nexus* to FERC-jurisdictional transmission and stranded costs in the two contexts (retail vs. retail-turned-wholesale) is different. In the retail wheeling context, there is *no causal nexus* between stranded costs and transmission that has been *ordered by this Commission*. In the retail-turned-wholesale context, in contrast, the opportunity for a utility to seek recovery of stranded costs is grounded on the existence of a *direct causal nexus* between stranded costs and transmission that has been *ordered by this Commission*.

We will reject the rehearing petitions that ask the Commission to act on request for stranded cost recovery associated with retail wheeling customers not only when the state commission lacks authority, but also when the state commission has authority but either has declined to use it or has only allowed partial recovery. As explained above, our decision to entertain requests to recover stranded costs caused by retail wheeling in a limited circumstance (when the state regulatory authority does not have authority under state law to address stranded costs when the retail wheeling is required) is based on our determination to fill any regulatory gap that arises in association with interstate transmission.

We will reject TX Com's request that the Commission clarify that section 35.26(d) (dealing with recovery of retail stranded costs), which refers only to public utilities, should also refer to transmitting utilities. The Commission's decision to act as a limited backstop in the case of stranded costs associated with retail wheeling customers is based on our jurisdiction under sections 205 and 206 of the FPA over the rates, terms, and conditions of retail transmission in interstate commerce. As a result, our ability to allow the recovery of such costs through a surcharge on a section 205 unbundled transmission rate is necessarily limited to public utilities.[721]

Rehearing Requests Opposing Commission Treatment of Stranded Costs Associated with Retail Wheeling Customers in Holding Company Intra-system Agreement Cases

A number of entities oppose the Commission's proposal to address on a case-by-case basis whether jurisdictional intra-system agreements may need to be amended in order to prevent inappropriate cost-shifting that could occur if one state disallows stranded cost recovery associated with retail wheeling customers. IN Com objects that the problem is not the actions of one state or another, but rather the terms of the intra-system agreement.

AR Com objects that Order No. 888 is factually in error because a state's treatment of retail stranded costs under the Entergy System Agreement cannot shift costs to other jurisdictions.[722] It submits that whenever retail load changes, whether due to retail wheeling or any other factor, responsibility ratios under Entergy's reserve equalization schedule, MSS-1, will change and costs will shift irrespective of the regulator's treatment of retail stranded costs. AR Com says that MSS-1 reveals no changes in calculations due to retail treatment of stranded costs or any other retail ratemaking only "excess" capacity costs of intermediate gas and oil-fired plant are "shifted" under the Entergy System Agreement. Although the Commission has the authority to amend intra-system agreements when wholesale cost allocations have become unjust and unreasonable. AR Com submits that the Commission does not have jurisdiction to reach to the state level and dictate what retail ratepayers should pay to shareholders. AR Com maintains that a FERC-jurisdictional intra-system agreement extends only to sales for resale (transactions among subsidiaries), and that if a holding company believes that an intra-system agreement is unduly discriminatory as a result of a state's disallowance of costs, the holding company can propose to amend it.[723]

AR Com argues that retail stranded costs fall to state jurisdiction regardless of whether the utility is a member of an interstate holding company, AR Com says that because the costs at issue are in retail rate base, any Commission influence over their recovery could occur only through preemption, but preemption of a state disallowance from retail rate base is possible only if there is a "trapped cost." AR Com submits that a disallowance of retail rate base cost cannot result in a trapped cost because there is no inconsistency between two agencies acting within their jurisdiction; the Commission has no jurisdiction to act. AR Com maintains that, unlike the Grand Gulf situation, the Commission has not mandated any Entergy generation costs into retail rate base. It further says that different state decisions regarding recovery of retail costs are not inconsistent decisions; they represent each state applying its law to its facts. According to AR Com, decisions by states leading to less than full recovery could be deemed inconsistent decisions only if there were a federal guarantee of full cost recovery of retail costs, which there is not.

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[721] We note that the definition of "retail stranded cost" in section 35.26(b)(5) mistakenly refers to " a public utility *or* transmitting utility" (emphasis added). We will revise the definition to remove the reference to "transmitting utility."

[722] *See also* MO/KS Coms (the cost-shifting problem does not arise because of a particular state treatment of stranded costs, it arises because Energy insists on recovering 100 percent of its costs even when some portion of the costs are not economical).

[723] AR Com also objects to the Commission's description of the issue as involving not only holding companies, but also other multi-state situations. AR Com says that "[t]he mere fact that a company's territory crosses state lines does not automatically mean that all assets serve all customers, or that all customers are required to bear the economic risk associated with all assets, or that assets that at one time were solely state-jurisdictional can somehow, by virtue of a company's decision to expand across state lines, before FERC-jurisdictional" AR Com at p. 11.

AR Com and MO/KS Coms assert that the Commission's proposal for holding company situations cannot apply to future holding companies, where there is no history of joint planning justifying cost equalization, nor can it apply to future investments. They contend that this would require an assumption that the utility subsidiaries of a registered holding company have planned, and should plan, together rather than separately (i.e., that interaffiliate transactions are always more efficient than nonaffiliate transactions), and that such assumption would be sound only if having the transaction occur between affiliates is inherently more efficient than having the transaction occur between an affiliate and a nonaffiliate.

Commission Conclusion

The comments raised for the most part are either premature or reflect a misunderstanding of the Commission's decision. Contrary to AR Com's argument, the Commission in Order No. 888 in no way asserted jurisdiction over state determinations of stranded costs associated with retail wheeling customers. We agree with AR Com that our jurisdiction extends only to sales for resale (and transmission in interstate commerce) and that a holding company can seek to amend an intra-system agreement if it believes the agreement is unduly discriminatory as a result of a state's disallowance of costs. However, a holding company also may seek to amend an agreement *before* any potential disallowances can occur, to keep cost-shifting from occurring. The fact is that intra-system agreements which involve wholesale sales among affiliate companies in different states could, through operation of their reserve equalization formulas, result in customers in one or more states having to indirectly bear stranded costs that are disallowed in another state, and the Commission has a responsibility to prevent inappropriate cost-shifting. Such determinations can be made only on a case-by-case basis. Again, as we stated in Order No. 888, we encourage affected state commissions to propose mutually agreeable solutions to this potential problem.

8. Evidentiary Demonstration Necessary—Reasonable Expectation Stranded

In Order No. 888, the Commission concluded that a utility seeking to recover stranded costs must demonstrate that it had a reasonable expectation of continuing to serve a customer. We stated that whether a utility had a reasonable expectation of continuing to serve a customer, and for how long, will be determined on a case-by-case basis, and will depend on all of the facts and circumstances. We also determined that the existence of a notice provision in a contract would create a rebuttable presumption that the utility had no reasonable expectation of serving the customer beyond the specified period. We said that whether or not a contract contains an "evergreen" or other automatic renewal provision will be a factor to be considered in determining whether the presumption of no reasonable expectation is rebutted in a particular case.[724]

We also said that we would apply the reasonable expectation standard to retail-turned-wholesale customers. We explained that, before the Commission will permit a utility to recover stranded costs, the utility must demonstrate that it incurred such costs based on a reasonable expectation that the retail-turned-wholesale customer would continue to receive bundled retail service. Whether the state law awards exclusive service territories and imposes a mandatory obligation to serve would be among the factors to be considered in determining whether the reasonable expectation test is met in a particular case.[725]

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[724] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996*, at p. 31,831; *mimeo* at pp. 570-72.

We noted that Order No. 888 does not address who will bear the stranded costs caused by a departing generation customer if the Commission finds that the utility had no reasonable expectation of continuing to serve that customer. We indicated that we anticipate that, in such a case, a public utility will seek in subsequent requirements rate cases to have the costs reallocated among the remaining customers on its system. However, we stated that we were not prejudging that issue in the Rule.[726]

Rehearing Requests Opposing or Seeking Modification of the Reasonable Expectation Standard

APPA challenges the reasonable expectation standard as being too vague. It submits that the Commission has provided no guidance concerning application of the reasonable expectation standard, other than the state that it would decide the issue on a case-by-case basis. APPA objects that public utilities can exploit the uncertainty created by this standard, which will lead to costly and time-consuming litigation. IL Com supports replacing the reasonable expectation standard with a statutory, regulatory, contractual standard.

Several entities contend that there is no basis to conclude that the reasonable expectation test could ever be met. VT DPS and Valero submit that, since 1973, utilities have known that a refusal to wheel power could subject them to antitrust liability.

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[725] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at p. 31,831; *mimeo* at p. 572. We indicated that the same procedures would apply to retail customers that obtain retail wheeling.

[726] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at p. 31,831; *mimeo* at pp. 572-73.

They say that Order No. 888 ignores the breadth of NRC licensing conditions. LEPA similarly argues that the reasonable expectation standard could not be met where NRC license conditions required an explicit wheeling commitment and prohibited the utility from including in the wheeling cost any amount attributable to the loss of customers due to the wheeling. It objects that delaying a decision on stranded cost recovery in such cases holds the threat of possible stranded cost charges over the heads of bulk power purchasers and thereby chills their ability to seek competitive sellers.

TAPS asserts that there should be an irrefutable presumption that no stranded costs are due from customers with preexisting transmission rights, including customers who were the beneficiaries of NRC license conditions.[727] TAPS submits that there can be no legitimate "reasonable expectation" that such customers would continue to purchase power if the price was higher than the market price.

Occidential Chemical asks the Commission to clarify that a utility could have had no reasonable expectation of recovering stranded costs from customers who, prior to the issuance of the NOPR, had the opportunity to switch to an alternative electric supplier or had the option of self-generating, obtaining on-site third-party generation, or municipalizing. Occidental Chemical further argues that it defies commercial expectations to allow a utility to argue that if a contract is silent on the issue of renewal, the obligation to purchase does not expire with the termination of the contract. It submits that the Commission has not shown that it has the authority to force customers to extend purchase agreements against their will in violation of accepted commercial practice.

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[727] AMP-Ohio submits that where transmission access and competition have existed to varying extent for decades, there should be an irrebuttable presumption of no reasonable expectation of continued service.

A number of entities submit that the Commission erred in failing to treat a notice of termination provision as conclusive evidence that the utility had no reasonable expectation of continued service.[728] Several object that the Commission has failed to explain why the present of a notice provision does not conclusively demonstrate the lack of a reasonable expectation and *ipso facto* terminate the obligation of the customer to purchase the product.[729] APPA objects that the Commission provided no evidence that it considered comments supporting making the presumption conclusive and that it found legally sufficient reasons to reject them.

PA Munis objects that the rebuttable presumption represents an unjustified departure from the Commission's traditional policy of enforcing the express terms of notice provisions without any inquiry into the reasonable expectations of the party, provided that the agreements were negotiated in good faith and approved by the Commission.[730] PA Munis contends that wholesale requirements customers negotiated notice provisions with the knowledge that the Commission would enforce the notice provisions according to their terms, including the specific length of the term.[731] PA Munis argues that it is arbitrary and capricious to provide utilities an opportunity to seek to amend these contracts.

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[728] *E.g.*, APPA, American Forest & Paper, Central Montana EC, NRECA, TDU Systems, Oglethorpe, IMPA, VT DPS, Valero, PA Munis.

[729] *E.g.*, APPA, NRECA, TDU Systems. *See also* VT DPS and Valero (by signing a contract with a termination date, the utility assumed the risk that the customer will elect to leave when the contract expires).

[730] In support of its argument, PA Munis cites *Boston Edison Company*, 56 FPC 3414 (1976). *See also* American Forest & Paper.

[731] *Citing Kentucky Utilities Company*, 23 FERC ¶ 61, 317 (1983); *Philadelphia Electric Company and Susquehanna Electric Company*, 65 FERC ¶ 61,303 (1993).

Several entities submit that the rebuttable presumption invites litigation and promotes uncertainty for customers.[732] APPA objects that the Commission has failed to establish the showing that it would require to overcome the presumption.

Referring to the Commission's discussion of evergreen provisions, Central Montana EC argues that it is wrong to infer from the existence of an automatic renewal provision that the parties intended that the contract might run longer than its initial term. Central Montana EC asserts that the presence of an evergreen provision infers simply that the parties agreed upon a mechanism to avoid the renegotiation of a power supply contract if, at the conclusion of its initial term, the parties were satisfied with the contract. It maintains that the parties' obligations are defined by the term and termination provision of wholesale power contracts, and that the presence of a mechanism to avoid contract renegotiation does not alter those termination rights.

Commission Conclusion

We will reject the requests for rehearing of our decision to adopt a reasonable expectation standard to be applied on a case-by-case basis and to treat a notice provision in a contract as a rebuttable, not a conclusive, presumption of no reasonable expectation. Contrary to the claims of some entities, the Commission has explained the basis for its finding that utilities may have had an implicit obligation to serve their wholesale requirements customers and, therefore, that a utility should be given an opportunity to demonstrate that it incurred costs to provide service to a customer and that it had a reasonable expectation that it would continue to serve the customer beyond the contract termination date. The same factors that some petitioner contend establish the absence of a reasonable expectation of continued service may be offered as evidence to be considered in determining whether the reasonable expectation test is met in a particular case.

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[732] *E.g.*, NRECA, IMPA, PA Munis.

We believe that our decision to treat a notice of termination provision in a contract as creating a rebuttable presumption that the utility had no reasonable expectation of serving the customer beyond the period provided for in the notice provision is a reasonable one. It places evidentiary significance on the fact that a contract contains a notice of termination provision. Moreover, while it gives the utility an opportunity, based on the facts and circumstances of a particular case, to rebut the presumption of no reasonable expectation, it firmly places the burden of establishing reasonable expectation on the utility. Although some entities support treating notice provisions as a conclusive presumption of no reasonable expectation, as discussed below, we decline to adopt such an inflexible approach. Nevertheless, as we indicated in Order No. 888, when a utility is seeking a contract amendment to permit stranded cost recovery based on expectations beyond the stated term of the contract, we believe that the utility has a heavy burden in demonstrating that the contract ought to be modified.[733]

Contrary to the position of PA Munis, the rebuttable presumption is fully consistent with the Commission's past treatment of notice provisions. For example, the *Kentucky Utilities Company* case cited by PA Munis supports the proposition that, until a customer *exercises* a notice of termination provision, the utility is under an implicit obligation to continue to serve and plan for the future needs of the customer.[734] Thus, the presence of a notice of termination provision in a contract (particularly one not yet exercised by the customer), in and of itself, may not necessarily support the conclusion that the utility could never prove that it reasonably expected to continue serving the customer beyond the notice period.[735]

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[733] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at pp. 31,665, 31,813-14; *mimeo* at p. 87,522.

In response to APPA's objection that the Commission has failed to establish the showing that it would require to overcome the presumption, we note that the Commission cannot establish such a showing upfront because whether there is sufficient evidence to rebut the presumption of no reasonable expectation will depend on the facts of each case.

We appreciate the concerns expressed by some entities that the rebuttable presumption may increase the customer's uncertainty by inviting litigation. We have carefully weighed the pros and cons of treating a notice provision as a rebuttable presumption of no reasonable expectation versus the pros and cons of treating it as a conclusive presumption of no reasonable expection. It is true, as some entities assert, that the rebuttable presumption approach presents the potential for litigation between the parties as to whether, in a particular case, the utility can rebut the presumption. The alternative would be to treat all contracts with notice of termination provisions as conclusive evidence that the utility could have had no reasonable expectation it would continue to serve the customer beyond the specified notice period. While the latter approach presumably would reduce the number of cases in which the issue of a utility's reasonable expectation would have to be litigated, it would do so only by prohibiting a utility from ever demonstrating that, notwithstanding the existence of a notice provision, based on the facts of a particular case, the utility reasonably expected to continue serving the customer. While we do not prejudge the likelihood of a utility being able to rebut the presumption in a particular case, we believe that it would not be in the pubic interest for the Commission to absolutely preclude a utility from being able to make such a showing. On this basis, we conclude that treating a notice provision as a rebuttable, rather than a conclusive, presumption that the utility did not have a reasonable expectation of continuing service to the customer is, on balance, the fairer and more equitable approach.

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[734] *See Kentucky Utilities Company*, 23 FERC at pp. 61,679-80 ("Once it receives an effective notice of cancellation, Kentucky can stop planning for the future needs of that customer ... To be effective a notice of cancellation must contain a specification of the source of supply, the date on which the source of supply will be available, and an affidavit from the supplier that it will supply the customer on the date the contract ends").

[735] *See Potomac Electric Power Company*, 43 FERC ¶ 61,189 (1988) (suspending a notice of termination for five months due to questions about the impact of the proposed cancellation on service reliability).

Central Montana EC asserts that it is wrong to infer from the existence of an automatic renewal provision that the parties intended that the contract might run longer than its initial term. However, our statement in Order No. 888 that the existence of an automatic renewal provision will be a factor to be considered in determining whether the presumption of no reasonable expectation is rebutted in a particular case makes no such inference. Whether the utility can rebut the presumption will depend on the facts of each case.

Rehearing Requests Supporting Modification of Evidentiary Standard for Retail Customers

Several entities ask the Commission to consider adopting a rebuttable presumption that utilities had a reasonable expectation of continuing to serve any retail load for which they had a public utility obligation to serve. They submit that the burden should be on the former bundled retail customer to show that the utility's service obligation was not binding and that the utility's

expectation of continuing service was unfounded.[736] Florida Power Corp and Utilities For Improved Transition suggest that the only exception to such a rebuttable presumption should be for retail customers that gave notice of termination before the effective date of the Rule. EEI expresses concern that the issue may be wrongly decided on the existence (or lack) of any exclusive franchise. It states that while many states do award franchises delineating exclusive service territories, some do not, even though long-established service arrangements are in place. Puget submits that because there is a duty to serve all retail customers. Order No. 888 should provide for stranded cost recovery from all departing retail customers without application of a reasonable expectation test.

NY Com, on the other hand, opposes application of the reasonable expectation standard to stranded costs associated with retail-turned-wholesale customers. It argues that the reasonable expectation test would ignore prudence, customer impact, financial viability and a series of criteria traditionally analyzed by state regulatory agencies in determining rate treatment of costs incurred with the intention of providing service.

Commission Conclusion

We will deny the requests for rehearing of the Commission's decision to apply the reasonable expectation standard to retail-turned-wholesale and retail wheeling customers on a case-by-case basis without adopting a rebuttable presumption that utilities had a reasonable expectation of continuing to serve any retail load for which they had a public utility obligation to serve. When a utility seeks to recover stranded costs from former bundled retail customers, we think it is appropriate that the utility bear the burden of proving reasonable expectation (instead of requiring the customer to bear the burden of disproving the utility's reasonable expectation). Placing the burden on the utility is consistent with the requirement of sections 205 and 206 of the FPA that a public utility demonstrate the justness and reasonableness of its proposed rates. The same factors that are offered as support for the establishment of a rebuttable presumption of a reasonable expectation (such as the utility's obligation to serve all retail customers) may be offered by the utility as evidence to be considered in determining whether the reasonable expectation test is met in a particular case.

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[736] *E.g.*, EET, Oklahoma G&E, Southern, Florida Power Corp., Utilities For Improved Transition.

We also will deny NY Com's request that the Commission not apply the reasonable expectation standard to retail-turned-wholesale customers. We believe it is appropriate to require the same evidentiary demonstration for recovery of stranded costs from a retail-turned-wholesale customer as that required in the case of a wholesale requirements customer. Moreover, as discussed in section IV.J.7 above, the reasonable expectation standard contemplates evidence as to what a utility might reasonably expect to recover under state law, and we will give great weight to a state's view of what might be recoverable.

9. Calculation of Recoverable Stranded Costs

In Order No. 888, the Commission considered various proposals regarding how stranded costs should be calculated and who should pay. With respect to the calculation of stranded costs, the Commission rejected as overly complicated and costly an asset-by-asset approach to determine the amount of stranded costs assigned to a departing customer. Instead, the Commission determined that the revenues lost approach was the fairest and most efficient way to make this determination during the transition to a competitive wholesale bulk power market. The Commission adopted the following revenues lost formula for

calculating the stranded cost for each departing customer. SCO = (RSE — CMVE) x L. The Commission provided a precise definition for each component of the formula,[737] and made the application of the formula, and collection of the resulting stranded costs, subject to a number of conditions.[738]

RSE Issues

Numerous petitioners oppose the use of present revenues in the stranded cost forumla.[739] TDU Systems argues that the revenues lost approach is arbitrary and capricious because its effect exceeds its purpose. Specifically, TDU Systems contends that the revenues lost approach can permit over-recovery because it provides recovery of any difference between pre-Order No. 888 cost-plus rates and post-Order No. 888 competitive rates, regardless of the cause of the difference. TDU Systems cites enhanced utilization and technological improvements as two examples of pre- and post-Order No. 888 rate differences that are not competition related, but for which recovery would be provided. TDU Systems states that instead of using present revenues, RSE should be calculated based on the most current, reliable estimate of future revenues.

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[737] Briefly, SCO refers to the departing customer's stranded cost obligation, which is determined by taking the average annual revenues that the customer would have paid had it remained a customer of the utility (RSE), and subtracting from it the competitive market value of the power (on an average annual basis) no longer taken by the departing customer (CMVE). The difference represents the average annual stranded cost, which must be multiplied by "L" (L represents the period over which the utility reasonably could have expected to serve the departing customer beyond the contract termination, but for the open access required under Order No. 888 to produce the departing customer's total SCO.

[738] *FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* at pp. 31,839-40; *mimeo* at pp. 595-99.

[739] *E.g.*, TDU Systems, APPA, Central Vermont, ELCON.

Multiple Intervenors argues that the revenues lost method assumes that a utility's costs of operating its plants are *per se* reasonable, yet the New York utilities' current rates include levels of O&M, especially wages and benefits, expenses that may reflect inefficiencies and thus are not stranded costs for which a utility's shareholders should be compensated. Similarly, other petitioners oppose as backward-looking the use of present revenues for what should be a forward-looking remedy, consistent with the other elements in the formula.[740] TDU Systems argues that the use of past revenues is inappropriate in a falling cost environment, and notes that new capacity costs are less than the existing capacity costs embedded in a utility's rate base.

NYSEG states that the Commission should permit a utility to reconcile initial stranded cost charges to actual stranded costs on a periodic basis to account for changes in sales, energy purchases from NUGs, and changes in market price. NYSEG supports development of stranded cost charges based on three-year estimates. Under this approach, a customer would pay locked-in charges for a series of three-year periods. At the end of each period, the stranded cost estimate would be revised for the next three-year period. This process would continue until all stranded costs are recovered.[741] Other petitioners support the use of a projected revenue stream or a true-up mecha-

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[740] *E. g.*, TDU Systems, NRECA, Central Montana EC, SoCal Edison.

[741] *See also* Coalition for Economic Competition at p. 47.